



Public Company Accounting Oversight Board

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## ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS AND IMPOSING SANCTIONS

*In the Matter of Grant Thornton LLP,*

*Respondent.*

PCAOB Release No. 105-2017-054

December 19, 2017

By this Order, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") is: (1) censuring Grant Thornton LLP ("Grant Thornton," the "Firm," or "Respondent"), a registered public accounting firm; (2) imposing on Grant Thornton a civil money penalty in the amount of \$1,500,000; and (3) requiring Grant Thornton to undertake certain remedial actions.

The Board is imposing these sanctions on the basis of its findings that (a) from 2013 to 2014, Grant Thornton violated PCAOB rules, quality control standards, and auditing standards related to assignment, monitoring, and supervision of personnel in connection with two audit engagements it conducted for issuer audit clients in the financial services sector out of its Philadelphia office; and (b) Grant Thornton violated PCAOB rules and auditing standards in connection with its integrated audit of The Bancorp Inc.'s December 31, 2013 financial statements and internal control over financial reporting ("ICFR").

## 1.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), and PCAOB Rule 5200(a)(1) against Respondent.

## 11.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent has submitted an Offer of Settlement ("Offer") that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted,

## **ORDER**

Respondent consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.<sup>1</sup>

### **III.**

On the basis of Respondent's Offer, the Board finds that:<sup>2</sup>

#### **A. Respondent**

1. Grant Thornton LLP is a limited liability partnership organized under the laws of the state of Illinois, and headquartered in Chicago, Illinois. It has offices in multiple locations, including in Philadelphia, Pennsylvania, and is licensed under the laws of the state of Pennsylvania, among others, to engage in the practice of public accounting (License No. AF000387L). Grant Thornton registered with the Board on September 24, 2003, pursuant to Section 102 of the Act and PCAOB rules.

#### **B. Relevant Individual**

2. The "Bancorp Engagement Partner" was an audit partner in Grant Thornton's Philadelphia office beginning in 1998, and served as the engagement partner on Grant Thornton's audit of the December 31, 2013 financial statements and ICFR of The Bancorp Inc. ("Bancorp" or the "Company") and Grant Thornton's reviews of Bancorp's March 31, 2014 and June 30, 2014 financial statements.<sup>3</sup> At all relevant times, the Bancorp Engagement Partner was an associated person of a registered public accounting firm as that term is defined by Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i). The Bancorp Engagement Partner retired from Grant Thornton effective July 31, 2016.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other persons or entities in this or any other proceeding.

<sup>2</sup> The Board finds that Grant Thornton's conduct described in this Order constitutes (A) intentional or knowing conduct, including reckless conduct, that resulted in a violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard. See Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5).

<sup>3</sup> See *David M. Burns*, PCAOB Release No. 105-2017-055 (Dec. 19, 2017).

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**C. Issuer**

3. The Bancorp, Inc., the holding company for The Bancorp Bank (the "Bank"), is a corporation based in Delaware and a registered financial holding company. The Company's business is primarily conducted through its principal subsidiary, the Bank, a Delaware chartered commercial bank based in Wilmington, Delaware.

4. Bancorp is subject to supervision and regulation by the Federal Reserve, the Delaware Office of the State Bank Commissioner, and the Federal Deposit Insurance Corporation. At all relevant times, Bancorp's common stock was registered under Section 12(b) of the Securities Exchange Act of 1934 and was traded on the NASDAQ under the symbol TBBK. At all relevant times, Bancorp was an "issuer" as the term is defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). Grant Thornton has served as Bancorp's independent auditor since 2000.

**D. Summary**

5. This matter concerns Grant Thornton's violation of PCAOB quality control standards relating to personnel management during 2013 and 2014. Specifically, Grant Thornton violated PCAOB quality control standards by assigning two partners from its Philadelphia office, with known audit quality concerns, to serve as engagement partners on two separate fiscal year end 2013 issuer audits, without providing them sufficient support or monitoring. The Firm also failed to comply with PCAOB rules and standards in connection with its audits of Bancorp's December 31, 2013 financial statements and ICFR.

6. Prior to the Philadelphia office's year-end 2013 audits, Grant Thornton had significant concerns with the proficiency and technical competence of two engagement partners in its Philadelphia office's financial services group, including the Bancorp Engagement Partner and another financial services partner ("Partner B"). Those concerns led Grant Thornton to place Partner B on a performance improvement plan and to develop other remedial plans to address audit quality issues within the office. Despite those concerns, Grant Thornton failed to take sufficient steps to properly support or monitor the Bancorp Engagement Partner and Partner B when it assigned each to serve as an engagement partner on two separate 2013 issuer audits for financial services clients.

7. The Firm's failure to maintain effective quality controls contributed to Grant Thornton's violation of PCAOB rules and standards in connection with its 2013 integrated audit of Bancorp. Specifically, Grant Thornton, among other things, failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence concerning the reported value of

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Bancorp's net loans, the effectiveness of Bancorp's controls relating to its allowance for loan and lease losses ("ALLL"), and the reasonableness of Bancorp's ALLL – a known significant risk and significant accounting estimate. As a result of its failures to perform the audit in conformity with PCAOB standards, Grant Thornton failed to obtain sufficient appropriate audit evidence to support its audit opinions on Bancorp's financial statements and ICFR.

8. On April 1, 2015, Bancorp announced that its previously issued financial statements for the years ended December 31, 2012 and 2013 and the quarterly financial statements within those years and for the first three quarters of 2014 should no longer be relied on because certain provisions for loan losses related to commercial loans were taken in incorrect periods. Ultimately, the restatement resulted in a \$141 million reduction in Bancorp's net loans as of December 31, 2013, as well as increases in Bancorp's provision for loan and leases losses of \$28.9 million (or 98 percent) during 2013 and \$90.5 million (or 403 percent) during 2012, respectively.<sup>4</sup>

**E. Grant Thornton Violated PCAOB Rules and Standards in its Assignment, Support, and Monitoring of Personnel Assigned to Two Year-End 2013 Issuer Audits for Financial Services Clients.**<sup>5</sup>

**a. Applicable Standards**

9. PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and quality control standards.<sup>6</sup>

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<sup>4</sup> Although Bancorp initially announced that the restatement would impact only its December 31, 2012 and 2013 financial statements, the Company ultimately restated its December 31, 2010 and 2011 financial statements as well.

<sup>5</sup> All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the relevant audit or review. As of December 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015); *see also PCAOB Auditing Standards Reorganized and Pre-Reorganized Numbering* (January 2017), <https://pcaobus.org/Standards/Auditing/Documents/ReorganizedandPreReorganizedNumbering.pdf>.

<sup>6</sup> *See* PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*; PCAOB Rule 3400T, *Interim Quality Control Standards*.

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Among other things, PCAOB auditing standards require that auditors make "appropriate assignments of significant engagement responsibilities" and provide that the "knowledge, skill, and ability of engagement team members with significant engagement responsibilities should be commensurate with the assessed risk of material misstatement."<sup>7</sup> PCAOB auditing standards further require that auditors provide the "extent of supervision that is appropriate for the circumstances, including, in particular, the assessed risk of material misstatement."<sup>8</sup>

10. A firm's system of quality control provides a critical foundation and infrastructure for a firm's audit quality as it should "ensure that services are competently delivered and adequately supervised."<sup>9</sup> PCAOB quality control standards require a registered firm to "have a system of quality control for its accounting and auditing practice,"<sup>10</sup> including policies and procedures concerning personnel management.<sup>11</sup> With respect to personnel management, firms should consider the nature and extent of supervision to be provided when making assignments.<sup>12</sup> The more able and experienced the personnel assigned to a particular engagement, the less direct supervision required.<sup>13</sup> PCAOB quality control standards further require that firms "establish policies and procedures to provide the firm with reasonable assurance that ...

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<sup>7</sup> See Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), ¶ 5; see also AU § 230.06, *Due Professional Care in the Performance of Work* ("Auditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining.").

<sup>8</sup> See AS No. 13 ¶ 5.

<sup>9</sup> See QC § 20.02, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (quoting AICPA Code of Professional Conduct, "Article VI—Scope and Nature of Services").

<sup>10</sup> See QC § 20.01.

<sup>11</sup> See QC §§ 20.11-.13.

<sup>12</sup> See QC § 20.11.

<sup>13</sup> See *id.*

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[w]ork is assigned to personnel having the degree of technical training and proficiency required under the circumstances."<sup>14</sup>

11. PCAOB quality control standards emphasize the "significant responsibilities" of individuals who supervise audit engagements and sign or authorize the issuance of audit reports.<sup>15</sup> In recognition of those significant responsibilities, firms are required to establish policies and procedures that "provide reasonable assurance that a practitioner-in-charge of an engagement possesses the competencies necessary to fulfill his or her engagement responsibilities."<sup>16</sup> Among the competencies expected is professional judgment, which typically "include[s] the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report necessary in the circumstances."<sup>17</sup>

12. As described below, Grant Thornton failed to comply with PCAOB rules and standards in connection with the assignment of personnel to two issuer audits for financial services clients, including the 2013 Bancorp audit.

**b. Grant Thornton was Aware of Audit Quality Problems with Partners in its Philadelphia Office in 2013-2014**

13. Grant Thornton violated PCAOB quality control standards relating to personnel management by assigning two partners, with known audit quality concerns, to two separate year-end 2013 issuer audits without providing sufficient support or monitoring. Indeed, Grant Thornton knew that there were proficiency and audit quality problems with respect to the Bancorp Engagement Partner and Partner B. Among other

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<sup>14</sup> See QC § 20.13.

<sup>15</sup> See QC § 40.03, *The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement* (in light of such "significant responsibilities," a firm's policies and procedures "should be designed to provide a firm with reasonable assurance that such individuals possess the kind of competencies that are appropriate given the circumstances of individual client engagements").

<sup>16</sup> See QC § 40.06.

<sup>17</sup> See QC § 40.08.



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things, Grant Thornton knew that the Bancorp Engagement Partner and Partner B had failed to appropriately perform certain issuer audits in prior years. Nonetheless, the Firm, in violation of PCAOB quality control standards, assigned the Bancorp Engagement Partner and Partner B each to lead a 2013 audit engagement team without the degree of technical training and proficiency required under the circumstances and failed to provide sufficient support or monitoring to those teams.

### **i. The Bancorp Engagement Partner**

14. As early as 2011, Grant Thornton, including individuals at top levels of Firm management, knew of significant audit quality issues with some of the Bancorp Engagement Partner's past audit work. Between 2010 and 2014, the Bancorp Engagement Partner served as the engagement partner or engagement quality reviewer on several audits that subsequently received "noncompliant" or "compliant with comments" ratings during Grant Thornton's audit practice reviews ("APR"s)<sup>18</sup> and/or were subject to a PCAOB inspection in which the inspection team identified deficiencies of such significance that it appeared that the Firm had not obtained sufficient appropriate audit evidence to support its opinion.

15. For one Grant Thornton issuer audit of a financial services client pre-dating the 2013 Bancorp audit, a PCAOB inspections team found that the Bancorp Engagement Partner and his engagement team had failed to obtain sufficient appropriate evidence to support the financial statement and ICFR opinions because the team failed to properly test the entity's ALLL-related controls and failed to perform sufficient substantive procedures over the entity's ALLL and loans receivable. For another pre-2013 audit on which the Bancorp Engagement Partner served as the engagement partner, Grant Thornton's APR team was "unable to conclude that the work was performed in accordance with PCAOB standards," finding that "there were significant departures from ... PCAOB standards, GAAP and/or firm policy." Additionally, both the PCAOB staff, through an inspection, and Grant Thornton, through an APR, ultimately concluded that there were quality issues with the Bancorp Engagement Partner's 2012 integrated audit of Bancorp. Moreover, the Bancorp Engagement

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<sup>18</sup> As part of the APR process, an APR team reviews audit work papers for select audits that were completed during the prior year. The APR team assigns a rating to each audit it reviews based on the significance of its findings. Under the Firm's ratings, a "noncompliant" audit is one that failed to comply with PCAOB standards and/or firm policy. The Firm assigns a "compliant with comments" rating to audits that, in the Firm's view, complied with PCAOB standards but exhibited deficiencies in execution and/or documentation.

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Partner's 2012 performance appraisal included a negative comment from the National Professional Practice Department because of his overreliance on senior managers and failure to delve deeply enough into audit work papers.

16. In August 2013, Firm leadership attributed the Bancorp Engagement Partner's performance issues primarily to his overly burdensome workload. As a result, the Firm developed a plan to reduce his "gross charge hours supervised," *i.e.*, the total number of hours charged by individuals he was responsible for supervising. Despite that plan, the Bancorp Engagement Partner's total workload was not significantly reduced. Indeed, between Grant Thornton's fiscal years 2012 and 2014,<sup>19</sup> the hours that he personally charged remained relatively consistent and his non-billable hours actually increased, particularly as related to marketing activities.

17. Despite the known risks concerning the Bancorp Engagement Partner, Grant Thornton assigned him to serve as the engagement partner on the 2013 Bancorp audit without appropriate support or monitoring. Specifically, Grant Thornton failed to assemble an engagement team for that 2013 Bancorp audit that possessed the degree of technical training and proficiency required to properly audit Bancorp's financial statements and ICFR. Indeed, notwithstanding the Bancorp Engagement Partner's above-described recent history, the Firm elected to pair him with a senior manager who, as the Firm knew, also had issues with the quality of his audit work. Further, for the 2013 audit, the Firm reduced both the number of engagement team members and the team's experience level, as compared to the 2012 engagement team. Indeed, the senior manager was aware that the junior staff lacked the experience to draw certain audit conclusions, as he acknowledged in an email to the Bancorp Engagement Partner during the audit: "[T]he staff in the field are too inexperienced to understand what they've already done in order to draw connections between the different procedures and risks."<sup>20</sup>

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<sup>19</sup> Grant Thornton's fiscal year runs from August 1 to July 31.

<sup>20</sup> The Firm's supervisory failures also included failing, through the Bancorp Engagement Partner, to properly assess the extent of supervision necessary for engagement team members to perform their work and form appropriate conclusions. See Auditing Standard No. 10, *Supervision of the Audit Engagement*, ¶¶ 5-6. Instead, Grant Thornton, through the Bancorp Engagement Partner, (a) failed to sufficiently review the work of the engagement team; (b) placed too much reliance on the senior manager; and (c) failed to develop an understanding of the instructions the senior manager provided to the staff.



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18. In addition, Grant Thornton failed to appropriately monitor the Bancorp Engagement Partner's work on the 2013 engagement in light of the Firm's knowledge of his history of poor audit quality. The Firm did not develop a plan sufficiently tailored to address its concerns with the quality of the Bancorp Engagement Partner's work or the risks inherent in the Bancorp engagement. It instead relied on the Firm's National Professional Practice Director Group ("NPPD") review process. Yet, although the Firm assigned an individual from its NPPD to review the engagement team's work on the 2013 Bancorp audit, that individual failed to complete his review of work papers he had requested concerning Bancorp's ALLL before authorizing the release of the Firm's audit report. Additionally, neither that individual nor anyone else at the Firm ever completed a separate, more detailed review of the audit required by the Firm's policies.

### **ii. Partner B**

19. As it had done with the Bancorp Engagement Partner, Grant Thornton assigned Partner B, who had known audit quality issues, to a 2013 issuer audit for a financial services client, without providing Partner B appropriate support or monitoring.

20. By 2013, Partner B had served as the engagement partner on four issuer audits that were subject to PCAOB inspections, through which significant deficiencies were identified. As a result of the PCAOB inspection findings and other indicators of poor audit quality, the Firm placed Partner B on a performance improvement plan ("Performance Plan"). According to the Performance Plan, Grant Thornton expected "no substandard audit results during the APR scheduled for July 2013 or the upcoming PCAOB review cycle." The Performance Plan stated that, if Partner B failed to make sufficient progress against the plan, Partner B could be subject to removal from the Firm's partnership.

21. In mid-2013, the Firm selected one of Partner B's 2012 issuer audits for a financial services client for an APR. The APR team identified 17 deficiencies and ultimately concluded that the audit was noncompliant with Firm policies and professional standards.

22. Despite knowing of Partner B's audit quality issues, including the non-compliant APR results, Grant Thornton again assigned Partner B to lead the audit engagement of the same financial services client. Grant Thornton also teamed Partner B with an engagement quality reviewer for the audit, who had limited experience on audits of financial services issuers. For that audit, as with the Bancorp audit, Grant Thornton also reduced both the number of engagement team members and the team's experience level from the prior year.

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23. As it had with the Bancorp Engagement Partner in the 2013 Bancorp audit, Grant Thornton again failed to develop a specific plan to address its concerns with the quality of Partner B's work. Instead, Grant Thornton assigned an NPPD reviewer to perform a detailed review of the 2013 audit of Partner B's audit of the financial services client, yet that review was never conducted.

24. In mid-2014, that audit was, however, selected for a special review by a member of NPPD, who identified a significant number of concerns related to Partner B's audit work. Although Partner B's Performance Plan stated that failure to make sufficient progress in improving audit quality could result in removal of Partner B from the partnership, Grant Thornton did not remove Partner B. Instead, the Firm merely lowered Partner B's quality rating and permitted Partner B to continue serving as an engagement partner on audits, including issuer audits, until late 2015.

### **c. Grant Thornton's Violations**

25. As described above, Grant Thornton was well aware that two partners in the financial services group in its Philadelphia office had significant and recent histories of failing to perform issuer audits in accordance with PCAOB standards. Yet the Firm continued to assign each of those two individuals as engagement partners on issuer audits without providing them sufficient support or monitoring. As a result, during 2013, the Firm violated PCAOB quality standards by failing to establish and implement policies and procedures to provide the Firm with reasonable assurance that (a) engagement partners possessed the competencies necessary to fulfill their responsibilities; (b) engagement teams possessed sufficient technical training and proficiency; and (c) its services were competently delivered and supervised.<sup>21</sup> In addition, the Firm violated PCAOB auditing standards by (a) assigning significant engagement responsibilities to engagement team members without the requisite knowledge and skill given the associated audit risks and (b) failing to provide appropriate supervision in the circumstances.<sup>22</sup>

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<sup>21</sup> See QC § 20.01, .11-.13; QC § 40.03, .06, .08.

<sup>22</sup> See AS No. 13 ¶ 5; AU § 230.06.

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**F. Grant Thornton Violated PCAOB Rules and Auditing Standards in Performing the 2013 Audit of Bancorp's Financial Statements and ICFR.**

**a. Background**

26. Prior to September 30, 2014, Bancorp, through the Bank, originated loans to commercial customers with whom it had established banking relationships. Those loans took the form of commercial term loans and lines of credit, commercial mortgages, and construction, acquisition, and development loans (collectively "Commercial Loans"). At December 31, 2013, Bancorp originally reported total assets of \$4.7 billion, including \$2.0 billion in loans. Commercial Loans constituted \$1.3 billion or 68 percent of Bancorp's loan portfolio.

27. To reflect the inherent credit risk associated with its loan portfolio, Bancorp recorded an ALLL to cover probable losses that existed in the loan portfolio as of each period end. Bancorp's ALLL comprised two components, specific reserves based on potential losses on individually classified loans, and a general loss reserve for non-classified loans. Bancorp calculated the specific reserve portion of the ALLL by first identifying problem loans or leases through delinquency monitoring and loan file reviews. For loans risk rated special mention or below, Bancorp analyzed the "most probable sources of repayment and liquidation of collateral" to assess whether a reserve was required. To the extent the expected cash flows or fair value of collateral was less than the loan balance, Bancorp established an impairment reserve.<sup>23</sup>

28. Bancorp calculated its general reserve portion of the ALLL based on the application of historical loss experience and other factors to pools of loans with similar characteristics. Bancorp then adjusted the general reserve to reflect current economic conditions, current loan portfolio performance, loan concentrations, and other factors identified by management.<sup>24</sup> Grant Thornton understood that the loss experience or loss factors Bancorp used to calculate the general reserve were determined by calculating historical charge-off rates for each type of loan by risk rating. The Firm also understood that Bancorp's loan risk ratings were determined based on delinquency status and/or Bancorp's loan review process. In determining its ALLL, as well as for disclosure purposes, Bancorp needed to determine whether a loan should be classified as a troubled debt restructuring ("TDR"). Such a classification was appropriate if Bancorp, in

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<sup>23</sup> See Bancorp Form 10-K, at 51-52 (Mar. 17, 2014).

<sup>24</sup> See *id.*

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the course of restructuring a loan, "for economic or legal reasons related to the [borrower's] financial difficulties grant[ed] a concession to the [borrower] that it would not otherwise consider."<sup>25</sup> Accordingly, as Grant Thornton was aware, Bancorp relied on its loan review process, risk ratings, and appraisals to calculate and assess the sufficiency of its ALLL, including to determine whether a loan should be classified as a TDR.

29. At December 31, 2013, Bancorp originally reported an ALLL of \$38.2 million, \$35.6 million of which was allocated to Commercial Loans. For 2013, Bancorp originally reported a provision for loan losses, net interest income, and net income of \$29.5 million, \$95.8 million, and \$25.1 million, respectively.

30. On April 1, 2015, Bancorp announced that its previously-issued financial statements for the years ended December 31, 2012 and 2013 and the quarterly financial statements within those years and for the first three quarters of 2014 should no longer be relied upon. On September 28, 2015, Bancorp filed restated financial statements, reducing its net loans by \$141 million as of December 31, 2013. In addition, the Company's provision for loan and leases losses increased by \$28.9 million during 2013 and \$90.5 million during 2012. As a result of the increased provisions, Bancorp reported net losses for both 2013 and 2012.

31. In connection with its restatement, Bancorp also disclosed the following two material weaknesses in its ICFR: (i) "Credit file maintenance and evaluation – We did not properly maintain credit files, including the evaluation of loan collateral and industry-specific information, relevant in determining the appropriate risk-ratings of our loans, in identifying the ultimate occurrence of loss events, and in calculating impairment under ASC 310 'Receivables'; and (ii) "Discontinued Operations – Our controls were not effective in identifying the appropriate classification of items to be included as discontinued operations."

### **b. Applicable Auditing Standards**

32. An auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.<sup>26</sup> Among other things, PCAOB

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<sup>25</sup> See ASC 310-10-40. For a description of the criteria for assessing whether a loan restructuring should be classified a TDR, see ASC 310-10-40. Once a loan is deemed to be a TDR, that loan is accounted for as an impaired loan and must be measured for impairment at each reporting period. See ASC 310-10-35.

<sup>26</sup> See AU § 508.07, *Reports on Auditing Financial Statements*.

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standards require an auditor to exercise due professional care, exercise professional skepticism, and plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion.<sup>27</sup>

33. 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 under audit."<sup>28</sup> Under PCAOB standards "[t]he auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest."<sup>29</sup>

34. In designing the audit procedures to be performed, PCAOB auditing standards require that the auditor "[o]btain more persuasive audit evidence the higher the auditor's assessment of risk."<sup>30</sup> PCAOB standards further require that an auditor evaluate the results of the audit to determine whether the audit evidence obtained is sufficient and appropriate to support the opinion to be expressed in the auditor's report.<sup>31</sup> The "auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements."<sup>32</sup> Further, if audit evidence obtained from one source is inconsistent with that obtained from another, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the

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<sup>27</sup> See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230.01; Auditing Standard No. 15 ¶ 4, *Audit Evidence* ("AS No. 15").

<sup>28</sup> See AU § 333.02, *Management Representations*.

<sup>29</sup> See AU § 230.09.

<sup>30</sup> See AS No. 13, ¶ 9; see also Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit of Financial Statements* ("AS No. 5"), ¶ 46 ("As the risk associated with a control being tested increases, the evidence that the auditor should obtain also increases.").

<sup>31</sup> See Auditing Standard No. 14, *Evaluating Audit Results* ("AS No. 14"), ¶ 2.

<sup>32</sup> See AS No. 14 ¶ 3.

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audit.<sup>33</sup> PCAOB standards further require the auditor to modify the overall audit strategy and the audit plan "if circumstances change significantly during the course of the audit, including changes due to a revised assessment of the risks of material misstatement."<sup>34</sup>

35. Under PCAOB auditing standards, the auditor is required to assess the sufficiency of substantive tests of details. When planning a sample for a substantive test of details, the auditor should individually examine "those items for which, in his judgment, acceptance of some sampling risk is not justified."<sup>35</sup>

36. PCAOB standards require that the auditor form an opinion on the effectiveness of ICFR based on the auditor's evaluation of evidence obtained from all sources, including the auditor's testing of controls, misstatements detected during the financial statement audit, and any identified control deficiencies.<sup>36</sup> In conducting an integrated audit, the auditor should design his or her testing of controls to obtain sufficient evidence to support 1) the auditor's opinion on ICFR and 2) the auditor's control risk assessment for purposes of the financial statement audit.<sup>37</sup>

37. If an auditor plans to assess control risk at less than the maximum, and modifies the nature, timing, and extent of planned substantive procedures based on that lower assessment, "the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance."<sup>38</sup> An auditor's assessment of control risk should include an evaluation of

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<sup>33</sup> See AS No. 15 ¶ 29; see also AU § 333.04 ("If a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made. Based on the circumstances, the auditor should consider whether his or her reliance on management's representations relating to other aspects of the financial statements is appropriate and justified.").

<sup>34</sup> See Auditing Standard No. 9, *Audit Planning* ("AS No. 9"), ¶ 15.

<sup>35</sup> See AU § 350.21, *Audit Sampling*.

<sup>36</sup> See AS No. 5 ¶ 71.

<sup>37</sup> See AS No. 5 ¶ 7.

<sup>38</sup> See AS No. 13 ¶ 16. "A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective



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"evidence obtained from all sources, including the auditor's testing of controls for the audit of internal control and the audit of financial statements, misstatements detected during the financial statement audit, and any identified control deficiencies."<sup>39</sup> Auditors should also incorporate knowledge obtained in past audits of the issuer's ICFR into the decision-making process for determining the testing required during the current year audit.<sup>40</sup>

38. Auditors are required to assess control risk at the maximum for relevant assertions when controls necessary to address the risk of material misstatement are missing or ineffective, or when the auditor has failed to obtain sufficient appropriate evidence to support a control risk assessment below the maximum.<sup>41</sup> When an auditor identifies control deficiencies, PCAOB standards require that the auditor evaluate the severity of those deficiencies, and revise the control risk assessment and modify planned substantive procedures as necessary.<sup>42</sup>

39. When planning and performing audit procedures to evaluate accounting estimates, PCAOB standards require the auditor to "consider, with an attitude of professional skepticism, both the subjective and objective factors" on which management's estimate is based.<sup>43</sup> When management's estimate involves fair value measurements, the auditor must comply with PCAOB auditing standards concerning the

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would not be met." AS No. 5 Appx. A ¶ A3. "A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively." Id.

<sup>39</sup> See AS No. 13 ¶ 32.

<sup>40</sup> See AS No. 5 ¶ 57.

<sup>41</sup> See AS No. 13 ¶ 33.

<sup>42</sup> See AS No. 13 ¶ 34; see also AS No. 5 ¶ 48 ("When the auditor identifies deviations from the company's controls, he or she should determine the effect of any deviations on his or her assessment of the risk associated with the control . . . and the evidence to be obtained, as well as the operating effectiveness of the control."). The auditor is further required to determine whether the identified control deficiencies, individually or in combination, are material weaknesses. See AS No. 5 ¶ 62.

<sup>43</sup> See AU § 342.04, *Auditing Accounting Estimates*.

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auditing of fair value measurements and disclosures.<sup>44</sup> Under those standards, when a fair value measurement, such as an appraisal, is dated prior to the relevant financial reporting date, the auditor is required to obtain "evidence that management has taken into account the effects of events, transactions, and changes in circumstances occurring between the date of the fair value measurement and reporting date."<sup>45</sup> The auditor also evaluates whether "[m]anagement's assumptions are reasonable and reflect, or are not inconsistent with, market information" and whether "[m]anagement used relevant information that was reasonably available at the time."<sup>46</sup>

40. As described below, Grant Thornton failed to comply with these and other PCAOB auditing standards in connection with the audit procedures it performed and the opinions it issued on the 2013 Bancorp audit.

### **c. Grant Thornton Violated PCAOB Rules and Auditing Standards**

41. In planning the 2013 audit, Grant Thornton identified inadequate ALLL as a significant risk. Grant Thornton also identified as fraud risks additional allowance-related risks, including "charge-offs used to conceal theft" and "non-performing loans concealed by manipulation of records." Grant Thornton's engagement team assessed the inherent risk for the ALLL as high based on the subjectivity associated with the estimates and the potential for management bias. Grant Thornton's guidance also identified the heightened risk associated with the ALLL, as well as the "critical" role loan reviews and appraisal evaluations play in assessing the ALLL.

42. In planning its 2013 audit of Bancorp, Grant Thornton adopted a controls reliance approach to evaluating the reasonableness of the valuation of Bancorp's ALLL. As the audit progressed, the Firm failed to obtain sufficient appropriate audit evidence to support its assertion that Bancorp's controls over the valuation of the ALLL were designed and operating effectively. Specifically, Grant Thornton failed to properly test the design and operating effectiveness of Bancorp's loan review and collateral monitoring controls, as well as the operating effectiveness of Bancorp's controls over the maintenance of loan files and identification and measurement of impairment.

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<sup>44</sup> See AU § 328, *Auditing Fair Value Measurements and Disclosures*; see also *In re John J. Aesoph, CPA and Darren M. Bennett, CPA*, Rel. No. 34-78490, 2016 WL 4176930 (SEC Aug. 5, 2016).

<sup>45</sup> See AU § 328.25.

<sup>46</sup> See AU § 328.26.

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43. Furthermore, because Grant Thornton failed through its insufficient testing to identify deficiencies in Bancorp's ALLL-related controls, the Firm failed to reassess the appropriateness of its controls reliance approach, failed to assess the impact on the Firm's risk assessment, and failed to appropriately expand the scope of its substantive procedures to mitigate the risk of material misstatement arising from those control deficiencies.

44. In addition, in performing substantive procedures to test net loans and the reasonableness of the ALLL, Grant Thornton failed to perform sufficient procedures to support its conclusions related to its substantive loan reviews. Specifically, Grant Thornton failed to perform substantive loan review procedures on non-impaired individually significant loans and loans with "qualitative risk factors," because the engagement team failed to identify any loans meeting these definitions. Moreover, with respect to the loans Grant Thornton did review, the Firm failed to identify and address red flags and other contrary evidence that called into question the collectability of the loans and management's TDR determinations.

45. As a result, Grant Thornton failed to obtain sufficient appropriate audit evidence to support its opinions on Bancorp's 2013 financial statements and on the effectiveness of Bancorp's ICFR.

**i. Grant Thornton failed to assess adequately the design and operating effectiveness of ALLL-related controls**

46. In performing procedures to support its financial statement and ICFR opinions, PCAOB standards required Grant Thornton to test both the design effectiveness and operating effectiveness of controls that were "important to the auditor's conclusion about whether the company's controls sufficiently address[ed] the assessed risk of misstatement to each relevant assertion."<sup>47</sup>

47. During the 2013 Bancorp audit, Grant Thornton failed to obtain sufficient appropriate evidence that specific controls over estimates for which there was a risk of material misstatement were designed and operating effectively. Specifically, Grant Thornton failed to obtain sufficient appropriate evidence to support its conclusions that (a) Bancorp's controls over loan file reviews and monitoring collateral were designed and operating effectively and (b) Bancorp's controls over maintaining loan files and identifying and measuring impairment were operating effectively. Moreover, Grant

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<sup>47</sup> See AS No. 5 ¶ 39. To satisfy this requirement, Grant Thornton identified key controls for testing.

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Thornton failed to obtain sufficient appropriate evidence to support the team's assessment that control risk was low.

48. With respect to Bancorp's controls over its loan review function, which were critical to the calculation of the ALLL, Grant Thornton failed to perform appropriate procedures to develop a sufficient understanding of the duties of individuals and departments associated with the loan review process. In particular, despite Firm guidance that emphasized the importance of an independent loan review function, Grant Thornton failed to sufficiently assess the potential impact that certain individuals within the Bank's lending function had on the process for assigning risk ratings.

49. Further, despite evidence from the engagement team's testwork suggesting potentially ineffective controls, Grant Thornton failed to perform sufficient procedures to assess:

- the adequacy of the timing and scope of Bancorp's loan review control;
- the completeness of Bancorp's loan files; and
- whether Bancorp complied with its own credit policy with respect to obtaining updated appraisals, obtaining timely information from borrowers and guarantors, and perfecting collateral rights.

50. Grant Thornton likewise failed to properly assess whether Bancorp's controls related to monitoring collateral were designed and operating effectively. Specifically, Grant Thornton:

- failed to obtain a sufficient understanding of whether the appraisal or valuation requirements set forth in Bancorp's credit policy were designed appropriately; and
- failed to properly evaluate contrary evidence, such as reliance on stale appraisals, indicating that Bancorp's control for monitoring and updating collateral values was not operating effectively.

51. Grant Thornton also failed to perform sufficient procedures to support its conclusions that the controls relating to Bancorp's measurement of impairment were operating effectively. Despite having raised concerns about management's use of unsupported discounts on aged appraisals during the 2012 audit, Grant Thornton failed to obtain sufficient evidence that management's practice did not continue to exist in 2013. In fact, in reviewing the impairment calculation for one loan, Grant Thornton noted

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that Bancorp rejected a recent appraisal of the loan's collateral and, instead, relied on a 2007 appraisal discounted by five percent. Grant Thornton, however, failed to sufficiently assess whether Bancorp's actions demonstrated management bias or a control deficiency.

52. In light of the deficiencies in Grant Thornton's testing of the design and operating effectiveness of Bancorp's ALLL-related controls, the Firm failed to obtain sufficient appropriate evidence to support its controls reliance approach and related risk assessment. As a result, Grant Thornton failed to obtain sufficient appropriate evidence to support its financial statement and ICFR opinions.

**ii. Grant Thornton violated PCAOB standards in evaluating net loans and the ALLL.**

53. Grant Thornton's procedures to evaluate the reasonableness of the valuation of net loans and the ALLL likewise fell short of complying with PCAOB standards. Specifically, the small number of loans Grant Thornton reviewed was insufficient to address the risks presented by Bancorp's loan portfolio. Further, Grant Thornton failed to sufficiently consider red flags or contrary evidence indicating that loans were impaired and/or TDRs and relied on management representations without obtaining relevant and reliable evidence to corroborate those representations. As a result, Grant Thornton failed to comply with PCAOB standards, including those requiring it to exercise due professional care and professional skepticism, obtain sufficient appropriate audit evidence, evaluate whether it obtained sufficient audit evidence, and perform procedures to resolve questions concerning inconsistent audit evidence.<sup>48</sup>

*The Firm's Loan Review Scope Failed to Respond to Known Risks*

54. Grant Thornton's substantive loan review procedures, which consisted of reviewing a random sample of 25 loans and four individually significant impaired loans, fell short of providing the Firm with sufficient appropriate evidence to conclude on the reasonableness of Bancorp's reported net loans and ALLL.<sup>49</sup>

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<sup>48</sup> See AU §§ 230.01, 09; AU §§ 333.03-.04; AU § 350.21; AS No. 5 ¶ 71; AS No. 14 ¶¶ 2-3, 32-36; AS No. 15 ¶¶ 4, 7, 10, 29.

<sup>49</sup> Moreover, Grant Thornton failed to ensure that the sample it selected was representative of the population of loans. Of the 25 loans that the engagement team reviewed as part of its random sample, 20 were direct finance leases or daily rental

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55. Among other things, during the 2013 audit, the Firm:

- Substantively reviewed fewer loans than the previous year even though the engagement team acknowledged that there had been no change in the risk associated with Bancorp's loans from 2012;
- Failed to review any non-impaired individually significant loans or loans based on qualitative risk factors (a) despite having reviewed 64 individually significant loans during the 2012 audit; (b) despite having identified certain risky loans that the engagement team characterized variously as "sticky," and "problematic;" (c) despite knowing that certain loans—in fact, 30 percent of Bancorp's portfolio of Commercial Loans—had been originated prior to the 2008 financial crisis and presented a different risk profile as compared to loans that were originated afterwards; and (d) despite the Firm's own guidance requiring review of "[l]oans that me[t] certain qualitative risk characteristics;" and
- Failed to properly evaluate multi-loan lending relationships, even when cross collateralization or cross default provisions were present, thus failing to consider factors necessary to conclude on the risks presented by Bancorp's multi-loan relationships and on any necessary allowance.<sup>50</sup>

*The Firm Failed to Respond to Red Flags and Contrary Evidence During its Loan Review Procedures*

56. In performing its loan review procedures, Grant Thornton failed to identify or give appropriate weight to contradictory evidence indicating that loans were

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lines of credit even though together they only represented \$195 million or 9.75 percent of the \$2.0 billion loan portfolio as of December 31, 2013.

<sup>50</sup> Cross collateralization is a provision in a loan agreement that gives the lender the right to use the collateral from one loan to secure another loan. Cross default is a provision in a loan agreement that states a borrower is in default on the loan if the borrower defaults on another loan.



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improperly risk rated, impaired, and/or TDRs. In fact, during its 2013 loan reviews, Grant Thornton was aware of the following information:<sup>51</sup>

- For one loan that was part of a \$17.8 million lending relationship, Grant Thornton had information that the borrower had insufficient income to service the interest payments on the loans yet concluded that the loans were not impaired because they were current. Grant Thornton did so despite clear indicators that the borrower was drawing on his line of credit with Bancorp to service the interest only payments on that same line of credit.
- For a second loan relationship, Grant Thornton concluded that the loans were not impaired despite the fact that two-thirds of the collateral securing certain of the loans had been sold and the borrower had not repaid any of the principal on those loans.
- On that same loan relationship, Grant Thornton concluded that the loans were not TDRs because the loans had not been modified and the borrower was not in financial distress. The Firm reached this conclusion even though its own work papers noted that, over the lives of these loans including during 2013, the loans had been modified or extended at least seven times, the borrower was diverting proceeds from the sale of collateral to service other loans, and there had been 18 late payments on one or more of the loans in the relationship.
- On a third lending relationship, Grant Thornton failed to expand its procedures to include all loans in the relationship despite clear indicators that other loans might be impaired. Significantly, Grant Thornton knew that the guarantor of one of the loans, who was also the borrower and/or guarantor across all loans in the relationship, had made only minimal payments, had been convicted in July 2012 for his role in a kickback scheme, and was serving a five-year prison sentence. Grant Thornton was also aware, through its review of another loan, that the guarantor's wife intended to repay the loan as part of a restructuring of the borrower's debt. Despite this

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<sup>51</sup> During the restatement audit, Grant Thornton relied on this same information, among other information, to concur in management's conclusion that Bancorp's ALLL needed to be restated.

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knowledge, Grant Thornton failed to sufficiently consider whether this information might impact other loans in the relationship.

- For one loan within another relationship, Bancorp relied on a stale pre-financial crisis appraisal to value a borrower's reported equity interest in a Las Vegas casino.<sup>52</sup> Grant Thornton was aware the borrower had significantly reduced the value of his reported equity interests in the casino from \$66 million to \$20 million, yet the Firm again failed to assess whether Bancorp's use of the stale valuation indicated a potential impairment or control deficiency.<sup>53</sup>

*The Firm Inappropriately Relied on Management Representations in Concluding on its Loan Review Procedures*

57. Although Grant Thornton identified concealment of nonperforming loans as a fraud risk, the Firm, during its loan reviews, relied on management representations without obtaining sufficient evidence to corroborate such representations, even when the risk of possible management bias was present:

- For example, in one lending relationship, Grant Thornton relied on management's representation that a third party intended to purchase buildings serving as collateral for three of the borrower's loans and that the proceeds would be sufficient to repay all remaining loans. The Firm, however, failed to obtain a copy of the purported offer or any other reliable evidence to support management's representations that there was a willing buyer or that the proceeds would indeed be sufficient to repay the loans.

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<sup>52</sup> Grant Thornton also failed to perform any procedures to test whether Bancorp had perfected its interest in the borrower's collateral. Had Grant Thornton done so it would have learned Bancorp's collateral rights were worthless as the company that owned the Las Vegas casino had folded in 2012 and filed for bankruptcy in 2013.

<sup>53</sup> Although PCAOB standards required Grant Thornton to evaluate control deficiencies identified during its substantive procedures, the Firm failed to identify and evaluate control deficiencies that were evident during its substantive procedures. See AS No. 5 ¶ 71 (auditors are required to evaluate evidence obtained from all sources, including any control deficiencies identified during the audit, when forming an opinion on the effectiveness of ICFR).

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- In another lending relationship, Bancorp, in measuring the necessary specific reserves, discounted a recovery strategy firm's valuation of commissions receivable (the collateral for the loans) by 30 percent. Grant Thornton concluded the specific reserves were reasonable yet failed to perform any procedures to assess the recovery strategy firm's valuation of the commissions receivable and further failed to obtain any evidence to corroborate management's 30 percent discount.<sup>54</sup>

### *The Firm Failed to Identify and Evaluate Potential TDRs*

58. Grant Thornton likewise failed to design and perform audit procedures to sufficiently address the risk of misstatement posed by a previously recognized TDR-related control deficiency. Because of the associated heightened risk, Grant Thornton was required to obtain more persuasive evidence to support the completeness assertion associated with Bancorp's TDR disclosures.<sup>55</sup>

59. Grant Thornton, however, failed to identify and include any loans modified during the first nine months of 2013 in its population of loans subject to substantive TDR completeness procedures. Indeed, Grant Thornton limited the population of loans subject to test work because of the change in controls Bancorp implemented during

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<sup>54</sup> Even though Bancorp engaged the recovery strategy firm to provide a valuation, and then used that valuation for purposes of calculating a specific reserve that Grant Thornton also used as evidence to support the reserve, the Firm failed to identify the firm as a specialist. Accordingly, the Firm violated AU § 336, *Using the Work of a Specialist*, because it failed to (a) evaluate the professional qualifications of the recovery strategy firm engaged by Bancorp; (b) develop an understanding of the methods and assumptions used by the recovery strategy firm; and (c) test the data Bancorp provided to the recovery strategy firm. See AU §§ 336.08-.09, .12 (when an auditor uses the work of a specialist as audit evidence, the auditor is required, among other things, to "consider the ... professional qualifications of the specialist in determining that the specialist possesses the necessary skill or knowledge in the particular field," obtain an understanding of the methods and assumptions used by the specialist, and conduct "appropriate tests of data provided to the specialist").

<sup>55</sup> For a description of the requirements related to the design of auditing procedures to respond to the auditor's assessment of risk, see AS No. 13 ¶ 9; see also AS No. 5 ¶¶ 57-58.

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October 2013. Thus, Grant Thornton failed to performed sufficient substantive testing to ensure that Bancorp's identification of TDRs for 2013 was complete.

60. Grant Thornton also failed to appropriately evaluate whether there was evidence that certain loans should have been classified as TDRs. As discussed above, in performing its loan review procedures, Grant Thornton failed to appropriately evaluate whether there was evidence that certain loans should have been classified as TDRs.

### **iii. Grant Thornton violated audit documentation requirements**

61. Grant Thornton also violated PCAOB auditing standards that required it to assemble for retention (referred to herein as "archive") a complete and final set of work papers (a) within 45 days of the release of its audit report; and (b) within 45 days of substantially completing field work for each of its quarterly reviews.<sup>56</sup> Specifically, Grant Thornton failed to (i) archive the first quarter 2012 and 2013 Bancorp quarterly review work papers and (ii) timely archive the 2013 Bancorp audit work papers. Then, Grant Thornton violated the Board's documentation standard by (a) making modifications to the 2013 audit work papers after the documentation completion date; and (b) making additions to the 2013 audit work papers after the documentation completion date, without properly identifying those additions in accordance with PCAOB standards.<sup>57</sup>

62. PCAOB standards also require that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to determine who performed the work and the date such work was

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<sup>56</sup> See Auditing Standard No. 3, *Audit Documentation*, ¶ 15; see also *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Release 2004-006, at 9 (June 9, 2004).

<sup>57</sup> PCAOB audit documentation standards provide that, after the documentation completion date, audit documentation must not be deleted or discarded from the audit file, but it may be added as long as the auditor documents the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding the documentation. See AS No. 3 ¶ 16. Although Grant Thornton's audit documentation software includes a report that is designed to identify all additions made to the work papers after the documentation completion date, the 2013 engagement team failed to timely input the report release date for the audit and, therefore, additions to the work papers were not properly documented in the Firm's report.

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completed.<sup>58</sup> To assist engagement team members in complying with this requirement, Grant Thornton's audit software permits more than one person to sign off as preparer for a work paper and permits individuals to sign off on behalf of someone else. Despite the requirements of PCAOB standards and the functionality of the Firm's software, the audit in-charge signed off as the sole preparer on a significant number of work papers for which she did not perform any procedures other than opening the work paper, skimming it to confirm it was complete, and attaching it to the audit file. Of particular significance, one engagement team member signed off as the sole preparer for all but four of the loan reviews performed as part of the Firm's control testing; however, she did not actually perform any procedures on those loan reviews beyond opening them and checking to see if they appeared complete and that the conclusions did not contradict the information she skimmed. Accordingly, Grant Thornton violated PCAOB audit documentation standards because certain 2013 audit work papers failed to accurately indicate who performed certain work.

**iv. Grant Thornton failed to appropriately evaluate facts discovered subsequent to its 2013 integrated audit report.**

63. PCAOB standards require an auditor to take certain steps when, after the auditor's report, the auditor becomes aware of information that relates to the financial statements and/or ICFR that it was not aware of at the time it issued an audit report and which is of such a nature and from a source that the auditor would have investigated it had it come to the auditor's attention during the course of the audit.<sup>59</sup> Grant Thornton violated these standards, during the first and third quarters of 2014.

64. Prior to the restatement, during the first quarter of 2014, Bancorp recorded provisions for loan and lease losses totaling \$17.3 million primarily due to three large commercial loans. At that time, Grant Thornton learned, in connection with the first quarter provision taken for one relationship, that the borrower had entered into a settlement agreement with Bancorp. Grant Thornton, however, failed to sufficiently consider whether the facts related to the settlement agreement, which led to the provision, occurred prior to the audit report date. Indeed, during the first quarter review, Grant Thornton failed to sufficiently consider whether those newly learned facts should have caused an earlier impairment, particularly given that it had previously known that the borrower's wife had requested, prior to December 31, 2013, that the loan

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<sup>58</sup> See AS No. 3 ¶ 6.

<sup>59</sup> See AU §§ 561.04-.05, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*; AS No. 5 ¶ 98.

## ORDER

relationship be restructured. Likewise, when Grant Thornton learned that Bancorp had received a new appraisal for collateral securing several of the loans, it failed to inquire as to when the appraisal was received and failed to sufficiently consider whether it was appropriate to record the additional provisions and related charge-offs prior to December 31, 2013.

65. Grant Thornton further violated PCAOB standards when it failed to sufficiently consider whether information presented in a third-party consultant report<sup>60</sup> indicated the existence of ALLL-related control deficiencies and possible unrecorded loan impairments as of December 31, 2013.<sup>61</sup> The report, which Grant Thornton obtained as part of its third quarter 2014 review procedures, noted that Bancorp's risk ratings tended to congregate too much in a specific Pass category, that the information in Bancorp's loan files was often incomplete, and that the amount of follow-up credit monitoring was limited in practice. The report recommended that a significant number of risk ratings be downgraded. The third-party that prepared the report ultimately calculated an expected material loss based primarily on the credit risk associated with the loans. Grant Thornton, however, failed to sufficiently assess whether the report's findings were based on facts that existed at or before December 31, 2013. Grant Thornton further failed to properly consider whether the report's conclusions were an indication that Bancorp's risk ratings as of December 31, 2013 were incorrect or that the ALLL might have been materially understated as of year-end.

## IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. In determining to accept Respondent's Offer, the Board considered efforts that the Firm has taken since the assignments of the Bancorp Engagement Partner and Partner A to the two issuer audits discussed above to enhance its system of quality control, including but not limited to: implementing changes to its process for assigning professionals to engagements, including placing a greater emphasis on assessing individual workloads of engagement partners; establishing requirements and

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<sup>60</sup> Bancorp retained a third-party consultant to conduct a review and valuation of its commercial lending portfolio in connection with its decision in the third quarter of 2014 to discontinue its commercial lending operations.

<sup>61</sup> Under AS No. 5 ¶ 98, auditors are required, consistent with AU § 561, to evaluate subsequently discovered facts that may have impacted their ICFR report.



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guidance designed to improve partner involvement in critical aspects of audits; and installing professionals who formerly held quality-related roles in leadership positions in the Philadelphia office region. Accordingly, it is hereby ORDERED that:

- A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Grant Thornton LLP is hereby censured; and
- B. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of \$1,500,000 is imposed upon Grant Thornton LLP. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Grant Thornton LLP shall pay the civil money penalty within 10 days of the issuance of this Order by (1) wire transfer in accordance with instructions furnished by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter, which identifies the payor as a respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006; and
- C. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), for a period of one year from the date of this order, Grant Thornton LLP shall arrange for a member of the Firm's National Professional Practice Department to conduct a pre-issuance quality control monitoring review of the audit work for each issuer audit for a financial services client in which the Firm's Philadelphia office prepares or issues an audit report or plays a substantial role in the preparation or issuance of an audit report.<sup>62</sup> The purpose of such pre-issuance review shall be to support the Firm in identifying deficiencies, if any, in the application of PCAOB rules or

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<sup>62</sup> For purposes of Grant Thornton's remedial actions, financial services client includes any bank, broker, dealer, asset management company, insurance company, real estate investment trust, or issuer with a material loan portfolio.

**ORDER**

standards, and adequately addressing those deficiencies prior to the issuance of the audit report; and

- D. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), for a period of one year from the date of this order, Grant Thornton LLP shall assign a financial services designated engagement quality reviewer from an office other than Philadelphia to each issuer audit that the Firm's Philadelphia office performs for a financial services client; and
- E. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(6), Grant Thornton LLP shall provide, within one year from the date of this order, additional financial services related professional education and training, covering among other topics the allowance for loan and lease losses, to associated persons in its Philadelphia office that are assigned to one or more financial services issuer audits; and
- F. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), Grant Thornton LLP is required within 400 days from the date of this Order, to have Grant Thornton LLP's Chief Executive Officer certify in writing to the Director of the Division of Enforcement and Investigations, Public Company Accounting Oversight Board, 1666 K Street N.W., Washington D.C. 20006, the Firm's compliance with paragraphs C through E above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Firm shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement and Investigations may reasonably request.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

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Phoebe W. Brown  
Secretary

December 19, 2017