

Securities Regulation Daily Wrap Up, ACCOUNTING AND AUDITING— Counsel for TierOne auditors argue there was no professional misconduct during audit, (Jul. 12, 2016)

[Click to open document in a browser](#)

By Jacquelyn Lumb

The SEC heard oral arguments in a cross-appeal from an initial decision of an administrative law judge by respondents John Aesoph and Darren Bennett and the Division of Enforcement. On June 27, 2014, the ALJ found that Aesoph and Bennett engaged in improper professional conduct under Rule of Practice 102(e) and Exchange Act Section 4C while serving as the engagement partner and the senior manager during KPMG, LLP's audit of the 2008 financial statements of TierOne Corporation, a holding company for TierOne Bank. The ALJ suspended Aesoph from appearing or practicing before the Commission as an accountant for one year, and suspended Bennett from appearing or practicing before the Commission as an accountant for six months. The respondents appealed the law judge's findings of liability and the sanctions imposed. The Division cross-appealed with respect to the sanctions, which it considered insufficient, and seeks suspensions of three years and two years, respectively.

The SEC alleged in 2013 that the auditors failed to obtain sufficient evidence to support management's estimates of fair value of the collateral underlying the bank's troubled loans in their audit of TierOne's 2008 financial statements. The SEC said the auditors relied on stale information and management's representations while ignoring numerous red flags.

Counsel for Aesoph. Counsel for Aesoph advised that the team assessed all of the available evidence and tested the bank's impairment process to ensure that management had followed GAAP with respect to each loan. The auditors saw a process that was functioning, in which the bank had recorded impairments to loans, he said. Counsel also maintained that the ALJ's decision did not apply FAS 157 or guidance that was issued by the Office of the Chief Accountant with respect to determining fair value during distressed sales and/or disclosures.

Counsel for Bennett. Counsel for Bennett said that the record does not show that his client poses any threat to the Commission's processes and that the alleged conduct does not come close to that of other managers that have been sanctioned by the SEC. He also noted that the ALJ ignored evidence presented by respondents' expert witness who said their conduct met professional standards. The expert also concluded that the existing controls were sufficient, contrary to the Division's finding that the internal controls identified and tested by the auditors did not effectively test management's use of stale and inadequate appraisals to value the collateral underlying the troubled loan portfolio.

Counsel for the Division. Nicholas Heinke, on behalf of the Division, said the audit reflected violations of due care, a lack of professional skepticism, and insufficient evidence in a critically risky audit area. He did not contend that the auditors failed to recognize the risk, but that the procedures they performed were seriously lacking as was the documentation of their procedures. The work papers showed that the auditors looked at the existing appraisals, which were nine-to-10 months old, inquired of management, but did not corroborate the evidence on which management relied. If a procedure is not documented, he added, it casts doubt on whether it occurred.

In response to an inquiry by Commissioner Michael Piwowar about the Division's appeal for longer suspensions, Heinke said the Division does not suggest any legal errors by the ALJ, only that the misconduct merited longer suspensions.

Missing document comes to light. In 2010, KPMG learned that TierOne had failed to disclose a document created by management which showed an internal analysis of estimates of additional loan loss reserves higher than had been disclosed during the audit. KPMG resigned from the audit engagement and withdrew its audit opinion relating to the year-end 2008 financial statements and TierOne's internal controls.

Counsel for Aesoph noted that the auditors assisted the Department of Justice in bringing the fraudsters to justice. Counsel for Bennett said the fraud directly affected the auditors' judgment since the information was not known at the time of the audit. The auditors were defrauded, he advised.

Chair Mary Jo White thanked counsel for their arguments and said the Commission would take the matter under advisement.

Attorneys: George Curtis (Gibson, Dunn & Crutcher LLP) for John Aesoph, CPA. Gary Bendinger (Sidley Austin LLP) for Darren Bennett, CPA. Nicholas Heinke for the SEC.

Companies: TierOne Corporation; TierOne Bank

LitigationEnforcement: AccountingAuditing Enforcement SECNewsSpeeches