PCAOB
Public Company Accounting Oversight Board

1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8435
www.pcaobus.org

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of Kabani & Co., Inc., Hamid Kabani, CPA, Michael Deutchman, CPA, and Karim Khan Muhammad, CPA,	PCAOB File No. 105-2012-002
	ORDER SUMMARILY AFFIRMING FINDINGS OF CERTAIN VIOLATIONS AND IMPOSITION OF SANCTIONS FOR THOSE VIOLATIONS
Respondents	January 22, 2015

I. Introduction

On April 22, 2014, the hearing officer issued an amended initial decision in this disciplinary proceeding, finding that the registered public accounting firm Kabani & Co., Inc., and three associated persons of the firm, Hamid Kabani, Michael Deutchman, and Karim Khan Muhammad, participated in a "wide-spread and resource-intensive effort" over several weeks in 2008 to alter documents in the audit files of three issuers in an attempt "to deceive PCAOB inspectors in an upcoming inspection about the deficiencies in the Firm's audit work papers." The decision found that Kabani's and Deutchman's misconduct was "intentional and knowing," and Khan's was "knowing, intentional, or at least reckless." The decision concluded that respondents thereby violated PCAOB Rule 4006, which requires public accounting firms and associated persons to cooperate with Board inspections, and PCAOB Rule 3100, which requires such firms and their associated persons to comply with applicable auditing standards. Here, the applicable auditing standard with which respondents failed to comply is Auditing Standard (AS) No. 3, which requires that a complete and final set of audit documentation should be assembled for retention within 45 days after the audit report release date.

For these violations of Board rules and standards, the decision imposed certain sanctions. Specifically, it revoked the firm's registration; permanently barred Kabani from associating with a registered public accounting firm and ordered him to pay a $100,000 civil money penalty; barred Deutchman from associating with such a firm, with leave to petition the Board to associate in two years, and ordered him to pay a $35,000 civil money penalty; barred Khan from associating with such a firm, with leave to petition

to associate in 18 months, and ordered him to pay a $20,000 civil money penalty; and censured all four respondents.

On May 23, 2014, Kabani, the firm, and Deutchman (identifying themselves as the "Kabani Respondents") together filed a petition for review of the amended initial decision. On May 27, 2014, Khan, unrepresented by counsel, also filed a petition for review. The parties have also filed various motions related to the petitions for review.

In one of those motions, filed on May 30, 2014, the Division of Enforcement and Investigations (Division) requested that we "expedite review" and allow the Division to supplement the record with publicly available information about ongoing audit work by the firm since the issuance of the Order Instituting Disciplinary Proceedings in this case on June 15, 2012. The Division asserted that this information, gathered from Securities and Exchange Commission filings by issuers disclosing audit fees they paid to Kabani & Co., demonstrates that the firm has continued to perform auditing work for public companies through 2014. The Division argued that the respondents, whose sanctions are automatically stayed pending their appeal, therefore pose a "significant risk to investors." It further argued that "[t]he evidence [against the respondents] is so extensive and unequivocal, and the Petitions for Review so patently meritless, that it is difficult to conclude that the Petitions have been filed for any purpose other than to delay sanctions and public revelation of [their] improper conduct." The Kabani Respondents opposed the motion to expedite, summarizing their exceptions to the amended initial decision and asserting that "[e]xpediting review—and hence forcing a more rushed, inherently less thorough and careful review—only compounds the mistakes that should now be corrected." Khan similarly opposed the motion.

On June 24, 2014, the Board issued an order extending the time for setting a briefing schedule pursuant to Board Rule 5462(a)(2), in order to consider the pending motions as well as to consider whether the initial decision or any portion of it would be appropriate for summary affirmance under Board Rule 5460(e). It is well established that summary affirmance can be an appropriate method of resolving administrative proceedings. *See, e.g.*, *Yuk v. Ashcroft*, 355 F.3d 1222, 1232 (10th Cir. 2004) (holding that "[d]ue process and principles of administrative law require nothing more" from an agency than providing respondents with "a meaningful and thorough review of their claims, and, in the [initial] decision, ... a reasoned explanation for the agency's decision, which [the court] can, in turn, review"); *Albathani v. INS*, 318 F.3d 365, 379 (1st Cir. 2003) (rejecting challenge to agency's use of summary affirmance and noting that "[c]ourts themselves use 'summary affirmance' or 'summary disposition' procedures" as "workload management devices"); *MBH Commodity Advisors v. CFTC*, 250 F.3d 1052 (7th Cir. 2001) (affirming CFTC's order of summary affirmance); *Cities of Bethany v. FERC*, 727 F.2d 1131 (D.C. Cir. 1984) (affirming such order by FERC).

Board Rule 5460(e) provides that we may summarily affirm an initial decision if "no issue raised in the petition for review warrants further consideration by the Board." Courts have found that, where the arguments raised on appeal "do[ ] not present any substantial reason to doubt the soundness" of the opinion below or where they "are so lacking in merit" that a full discussion of them is not warranted, it may be appropriate to summarily affirm all or part of that decision. *E.g., Brown v. Eppler*, 725 F.3d 1221, 1228 (10th Cir. 2013) (reversing district court's grant of summary judgment as to certain claims but summarily affirming remaining contentions without discussion); *In re Leventhal*, 2013 U.S. App. LEXIS 4767 (7th Cir. 2013) (summarily affirming findings of bankruptcy judge, and district judge who affirmed those findings).

Having reviewed the respondents' petitions for review and conducted a de novo review of the record, we conclude, as discussed below, that no issue raised in the petitions for review regarding the Rule 4006, AS No. 3, and resulting Rule 3100 violations found in the initial decision warrants further consideration by the Board. This case does not raise subtle questions about the interpretation or application of complex auditing rules. Rather, the central issue is whether or not respondents altered final audit files after the deadline for completing them had passed. Respondents spend the great majority of their petitions challenging the hearing officer's findings of fact, but our review showed the amended initial decision's presentation of the facts to be fairly based on a preponderance of the record evidence. *See* Board Rule 5204(a); *S.W. Hatfield, CPA*, SEC Rel. No. 34-69930, 2013 SEC LEXIS 1954 at *4 (July 3, 2013) (applying preponderance standard to review of PCAOB disciplinary proceeding).

In deciding that respondents had, in fact, engaged in a scheme to alter those files well after the relevant deadlines, the hearing officer marshaled several different sources of evidence in support of the findings of fact that underpin his findings of violation. That evidence includes parties' stipulations, investigative and hearing testimony, emails sent among firm employees in the months and weeks before the PCAOB inspection, audit work paper files, and a comprehensive expert report and related expert testimony. That evidence demonstrates a course of misconduct—including intentionally resetting computer clocks to make documents appear to have been finalized before operative deadlines—that is troubling on its face. But the changing, conflicting, and patently incredible explanations for these document alterations offered by respondents throughout this proceeding accentuate the gravity of the misconduct and underscore how meritless respondents' arguments to the contrary now are.

For the reasons discussed below, we summarily affirm, pursuant to Board Rule 5460(e), the amended initial decision's findings of those violations and its imposition of sanctions for those violations.

II. Summary of Amended Initial Decision's Findings of Violation

As detailed in the amended initial decision, Kabani & Co. is a small firm, employing about 20 people in an office in Los Angeles that comprises less than 2,000 square feet. At all relevant times, Kabani, Deutchman, and Khan were persons associated with that registered public accounting firm, as defined by Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201(9), and PCAOB rules. Kabani and Deutchman were the firm's only two partners. Kabani was informed in June 2008 that PCAOB inspectors would be conducting an inspection of the firm's audits; in July 2008 PCAOB inspectors notified him of the date the inspection would begin (October 20, 2008). In or around June 2008, Kabani held a staff meeting attended by, among others, Deutchman, Khan, and Rehan Saeed, an independent contractor who usually worked remotely and served as a concurring reviewer for some of the firm's audits. At the meeting, Kabani informed the group about the upcoming inspection. He explained that PCAOB inspectors had identified deficiencies in the firm's files on previous visits and that he wanted certain audit files reviewed in advance for deficiencies. He also explained that PCAOB rules permitted the firm to correct certain deficiencies and that Saeed would review some audit files to identify any missing documentation. Deutchman testified during the investigation that "[e]verybody was afraid of the inspection. Everybody was terrified of the PCAOB, almost paranoid of the PCAOB…." The firm's employee time records show that the file reviews completed in preparation for the inspection would consume a substantial amount of time, so much so that, as Saeed testified, the firm "couldn't do much billing" on other work.

Shortly after the staff meeting, Kabani gave Saeed a list of files to review and a checklist to use in reviewing the files for completeness. When the PCAOB inspectors disclosed to Kabani the list of companies whose audit files they would be reviewing during their site visit, Kabani forwarded that list to Saeed and instructed him to focus his efforts on those companies in which the PCAOB was interested. In several emails sent contemporaneously by a junior staff member, tasked with helping to manage the review, the effort is variously referred to as "PCAOB Cleanup" and "Rehan's PCAOB Cleaning-up." Kabani, Deutchman, and Khan are copied on nearly all of these emails and had significant responsibility for the audits being reviewed: of the three audits at issue in this proceeding, Kabani served as engagement partner for all three, Deutchman served as the concurring partner on all three, and Khan was the auditor "in-charge" for one. Yet they deny having any understanding of what "PCAOB Cleanup" meant. Khan, incredibly, testified that it was unclear whether the junior staff member "was asking PCAOB to clean something" and that it "looks like PCAOB is cleaning something."

In September and October 2008, Saeed reviewed the audit files of the companies Kabani chose; those files were electronic (most of which were in Microsoft Word, Microsoft Excel, or Adobe PDF file format) and were organized using software

called Engagement Manager. Central to this case are the three files documenting the firm's audits of three issuers, as defined by Sarbanes-Oxley Act Section 2(a)(7), 15 U.S.C. 7201(7)—Issuer A, Issuer B, and Issuer C—for the year ended December 31, 2007. In September and October 2008, Saeed reported to Kabani, Deutchman, and Khan that the files were incomplete and contained other deficiencies such as missing signatures on management representation letters and trial balances that did not agree. Email correspondence from staff assisting with the review shows the audit files were then "updated" to address Saeed's comments. AS No. 3 permits additions to be made to final audit files, but only if the person adding the information documents his or her name, the date of the addition, and the reason for doing so. The respondents made no such notations and gave the modified files to the PCAOB inspectors in October 2008.

Saeed stopped working with the firm in September 2009. Thereafter, he contacted the PCAOB to share concerns that he had about the firm's activities leading up to the 2008 inspection, and he provided documents to the Board that included emails and electronic copies of audit work papers that he had in his possession from the review Kabani had asked him to conduct. In response to Accounting Board Demands issued by the Board, the firm also produced copies of, among other things, audit files for the 2007 audits of Issuer A, Issuer B, and Issuer C. Those audit files were the same as, or a substantially identical backup copy of, the files given to PCAOB inspectors in October 2008. Saeed was charged with misconduct in this proceeding but made an offer of settlement to the Board, which we accepted on May 21, 2013. *See* Order Making Findings and Imposing Sanctions in the Matter of Rehan Saeed, CPA, PCAOB Rel. No. 105-2013-004 (May 21, 2013), *available at* http://pcaobus.org/Enforcement/Decisions/Pages/default.aspx.

A basic comparison of the versions of the audit files Saeed reviewed with the versions the firm provided to the Division in 2011, in response to the Accounting Board Demands, reveals some patent changes that were made to the final audit files after the document completion deadlines had passed. For example, in respondents' version of the Issuer A audit file, 41 work papers reflecting lead schedules or trial balances are facially different from Saeed's versions, the later of the two reflecting the resolution of earlier notations indicating further work needed to be done. As another example, respondents' version of the Issuer B file contained a management representation letter bearing a different date and containing substantially different representations than the analogous letter found in Saeed's version of the file.

But many more post-deadline changes became obvious upon forensic examination of the files. A computer data forensics expert retained by the Division explained, in his comprehensive report and in testimony, that computer documents contain metadata—i.e., information about the document itself, such as when and by whom it was created and last modified—that is preserved as part of the document and

available for forensic examination. The metadata in the electronic audit files produced by the firm shows that many documents were created and/or changed well after the document completion deadlines had passed. But the metadata also manifests a pattern of anomalous creation and modification dates—that is, many documents in each of the three audit files appear to have been created *after* they were last modified—which is impossible without someone or something acting on the computer's internal clock. The Division's expert explained that the evidence in this case demonstrates that each of these anomalous documents was probably opened on a computer whose clock had been intentionally set backward; then the user (including one or more persons variously logged in as "Hamid," "Kabani," "Hamid Kabani," "Karim," and "Mohammed") made some change to the document (sometimes a nearly invisible change, such as adding a carriage return after the last line in a field of text), and then saved the file, making it appear superficially that the document was older than it actually was. Documents in all three audit files produced by respondents bore unmistakable signs of having been intentionally backdated so that they seemed to comply with the applicable documentation completion deadlines in AS No. 3 when in fact they did not.

The hearing officer found that the expert's "methodologies were reasonable; his findings were detailed and meticulous; and his conclusions were well-reasoned and well-supported." Amended Initial Decision (I.D.) 26. He also noted that "[r]espondents were not able to undermine the validity of, or raise serious questions about, his findings and opinions." I.D. 27. The hearing officer accepted the expert's findings and conclusions, noting that they were "consistent with the email communications and Saeed's testimony evidencing a plan to alter the audit work papers in anticipation of the PCAOB inspection." I.D. 26. After considering and rejecting the arguments offered in defense by the respondents, the hearing officer concluded that "the Firm failed to cooperate with the PCAOB inspection by providing the inspectors with work papers for several audits that had been improperly altered after the deadline for completing the audit documentation" and that "Kabani, Deutchman, and Khan participated in the scheme to alter the work papers and to provide the altered work papers to the inspectors." I.D. 48.

III. Respondents Raise No Meritorious Arguments on Review

Most of the exceptions taken by the respondents to the amended initial decision consist of arguments that have already been aired before the hearing officer and were addressed in the decision itself. The petitions for review and the related motions practice have not identified any potentially meritorious challenges to the hearing officer's findings of violation of Rule 4006, AS No. 3, and consequently Rule 3100.

A. Arguments about the metadata and the state of the audit files

Before the hearing officer and now before the Board, respondents have made several principal arguments. First, they have offered a number of different explanations for why the metadata evidence did not necessarily demonstrate intentional misconduct. Their arguments ranged from conflicting to unsupported to implausible. For example, the respondents, at different times, suggested, among other things, that a software failure caused the anomalies, that the innocent act of importing already-existing files into the Engagement Manager program caused the modification dates to change, and even that perhaps any intentional resetting of the company's computer clocks might have been done to circumvent the time limitations in the temporary license agreement accompanying the trial version of a hypothetical software product. The hearing officer found nothing in these arguments sufficient to undermine the thorough, specific, and well-supported testimony of the Division's expert. Nor do we.

Second, respondents have contended that, evidence of backdating and late addition of documents aside, the copies of the audit files supplied to the Division cannot be relied upon to prove liability. They have argued variously that the files they provided to Saeed to review were not final files but were incomplete drafts to be reviewed as part of an internal inspection; that the files Saeed reviewed were not final and were merely being used to train junior staff members on how to conduct an audit; that the Issuer A file they provided to the Division was not the final version of the file given to inspectors because the real file was irretrievable; and that the electronic files in Engagement Manager were merely part of a larger collection of final audit files that included some unidentified (and unproduced) bank of hard copy files.[1/] As the hearing officer explained, these assertions are at odds with the evidence in this case, most notably with the testimony given by respondents themselves during the investigation that often squarely contradicted their assertions at the hearing and which respondents have offered no way to reconcile. For example, in investigative testimony given just days after he had produced the Issuer A file to the Division, Kabani twice told investigators

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[1/] The Kabani Respondents broadly argue that "[s]canning existing hard-copy documents (that are already part of the final set of work papers in a manila file) and putting them with electronic files does nothing to change the final set of audit work papers" and is not, therefore, a violation of AS No. 3 even if no notation is made to explain the addition. *See, e.g.*, Kabani Respondents' Corrected Post-Hearing Brief at 67; Kabani Respondents' Petition at 22; *see also* I.D. at 64, 69. We need not reach that issue because it is moot, given the specific facts of this case that show, for example, that the version of the files Saeed reviewed—which did not include any hard copy documents—were the final files, that at least one of the scanned files was intentionally backdated, and that there is no credible evidence proving the existence of the dual audit file system the respondents describe.

that the audit files he had produced to the Board in response to the Accounting Board Demands were exactly the same as those given to the PCAOB inspectors in 2008. The amended initial decision identifies many other similar instances demonstrating how respondents' testimony regarding the finality of the files being reviewed by Saeed and of the files produced to the Division was self-contradictory and how their "version of events defied the plain sense meaning" of the evidence. I.D. 50-58.

Third, respondents also object that the hearing officer's decision does not take into account how difficult it would be to manufacture the work papers that were supposedly missing from the deficient files. The version of the Issuer A file produced to the Division in 2011, which they cite as an example, contains over 900 documents that did not appear in the file reviewed by Saeed in 2008. Respondents suggest that, therefore, Saeed could not have been reviewing the final version of the Issuer A file in 2008 to help Kabani & Co. correct it, because it would have been impossible to correct that magnitude of deficiency by creating 900 work papers in less than two months. First, there has been no allegation that respondents created 900 work papers from whole cloth. Moving already extant work papers for several of Issuer A's subsidiaries into a complete file could have easily accounted for the additions in the time taken for the "PCAOB Cleanup" and is consistent with the evidence. *See* I.D. 30-31 & nn.180-81. The Division's expert estimated that the updates to the computer files he reviewed could likely have been completed within "a month or two." This would still have violated AS No. 3 because the fact of, and reason for, these post-deadline assembly activities were not recorded in the file. But, second, it is unnecessary to determine precisely how these 900 new documents came to reside in the file Kabani provided to the PCAOB. For even if we make no comparison between the two versions of the audit file and instead look only at Kabani's version, that file alone bears evidence of late-added files and intentional backdating that is more than sufficient to sustain a finding that respondents failed to cooperate with the PCAOB inspection. *See* I.D. 29-30; Hearing Exhibit D-220 at 21-22. We find no basis to credit respondents' arguments.

B. Credibility issues

Many of the respondents' exceptions in their petitions for review are based on an assertion that the hearing officer wrongly failed to credit their testimony and instead credited contrary testimony by Rehan Saeed, whom the respondents have characterized as a disgruntled ex-employee of Kabani & Co. who had a motive to testify falsely against the respondents because Kabani did not grant Saeed full partnership at the firm. They also argue that, because Saeed admitted to altering a document that he filed with the PCAOB in support of his answer, Saeed's testimony is generally unreliable. The hearing officer satisfactorily addressed these issues in his decision, however, concluding that, although he was "not without concerns regarding Saeed's conduct and motives," he nonetheless "found [Saeed] credible on the major aspects of

his testimony." I.D. 54. The hearing officer explained at length the bases for his conclusion, including that Saeed's testimony "on the key issues in this case was corroborated substantially by both the Firm's contemporaneous email traffic as well as the metadata in the audit work papers"; that Saeed took a professional risk in coming forward with his concerns about misconduct at the Firm; and that Saeed's testimony on key issues was "consistent" and not effectively challenged by respondents. I.D. 54-55. The hearing officer also explained in detail why he found that respondents, on the other hand, "were often not credible on issues pertaining to work paper alterations." I.D. 55. The decision describes respondents' professed inability to recall important events, contradictions in their responses to questions asked during investigative and hearing testimony, and wholesale attempts to distance themselves from evidence against them, as when Khan professed at the hearing to have "no independent recollection" of whether the responses in the answer he filed were accurate. I.D. 55-57.

Respondents have provided no basis for revisiting the hearing officer's credibility determinations, and the record provides ample basis for declining to do so. Indeed, respondents' continued attempts to distance themselves from the damaging testimony they gave during the investigation only underscore the validity of the hearing officer's conclusions. For example, the Kabani Respondents suggest in their petition for review that their investigative testimony should not be relied upon because the Division failed to "disclos[e] what charges was Kabani under the investigation so they could have prepared and explained three years old items" [sic]. An investigation—by definition a fact-finding exercise—necessarily precedes the institution of formal enforcement proceedings, which cannot be brought until the Board is satisfied that, "as the result of an investigation or otherwise," a hearing is warranted to determine whether a person subject to our jurisdiction has violated a professional standard, rule, or law. Board Rule 5200(a)(1). And, as pointed out by the hearing officer in his decision, the very fact that investigative testimony is given before a respondent knows how to discern the import of that testimony gives it particular value. I.D. 50.

Our conclusion is not altered by the Kabani Respondents' attempt on review to introduce new evidence regarding Kabani's truthfulness. The Kabani Respondents have filed a motion to supplement the record with the results of a lie-detector test administered to Kabani in May 2014, after the amended initial decision was issued. The Kabani Respondents claim that the polygraph exam results serve as "corroboration that they have told the truth" and prove that the amended initial decision "is wrong."

PCAOB Rule 5464 permits parties to file motions to adduce additional evidence prior to issuance of a Board decision but requires that "such motion shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." The Kabani Respondents have not addressed this rule and have offered no explanation for their failure to offer

polygraph evidence in proceedings before the hearing officer. They were represented by counsel during the six-day hearing, at which time they were given a full opportunity to present evidence, call and question witnesses, and vigorously mount a defense. In their motion, the Kabani Respondents note that Kabani was "so shocked by this the [sic] Hearing Officer's finding's [sic] in the Amended Initial Decision" that he submitted to the test, but, to the extent Kabani's surprise is offered as an explanation for why Kabani did not submit to a polygraph test before the hearing, it is not adequate. Witness credibility is an issue to be considered in nearly every adjudicated proceeding, as is the possibility of an unfavorable decision. A respondent cannot wait for an unfavorable decision before adducing material evidence. *See Gross v. SEC*, 418 F.2d 103, 108 (2d Cir. 1969) (upholding SEC's decision to reject respondent's bid to reopen hearing and testify on his own behalf where "[t]he only ground asserted for [respondent's] failure to testify [earlier] is the judgment of counsel at the time of the original hearings, which petitioner's present counsel has now concluded was unwise"), *citing with approval David T. Fleischman*, SEC Rel. No. 34-8187, 1967 SEC LEXIS 560 at *8 (Nov. 1, 1967) ("Public policy considerations favor the expeditious disposition of litigation, and a respondent cannot be permitted to gamble on one course of action and, upon an unfavorable decision, to try another course of action."); *Ralph W. LeBlanc*, SEC Rel. No. 34-48254, 2003 SEC LEXIS 1793 at *19 n.20 (July 30, 2003) (denying motion to adduce additional evidence where respondent "rationalize[d] the lateness of the submission on the ground that the significance of the materials was not made clear to him until the law judge rendered a decision that was plainly unfair to him").

Even if the tardiness of Kabani's effort to bolster his credibility could be ignored, he has failed to demonstrate that the test results are material to this case. Without citation to any supporting authority, the Kabani Respondents assert that polygraph tests are "widely considered to be accurate, although, not foolproof," and that "due process" should compel inclusion of the test results as evidence. The Kabani Respondents fail to acknowledge the significant weight of authority doubting the reliability and admissibility of polygraph test results in judicial proceedings. *See Carlton Wade Fleming, Jr.*, SEC Rel. No. 34-36215, 1995 SEC LEXIS 2326 at *5 n.5 (Sept. 11, 1995) (determining not to rely in reviewing NASD decision on testimony of polygraph examiner called by respondent, noting that, "[t]raditionally, courts have been reluctant to admit polygraph examinations"); *see generally* 1 Kenneth S. Broun, *McCormick on Evidence* § 206 (7th ed. 2013) ("A categorical rule of exclusion for polygraph results is a logical and defensible corollary to the general principles of relevancy."). In refusing to admit as evidence polygraph test results, courts have noted that "the technique is not generally accepted in the scientific community or is 'unreliable' due to inherent failings, a shortage of qualified operators, and the prospect that 'coaching' and practicing would become commonplace if the evidence were generally admissible." *Id.* Courts are especially reluctant to admit polygraph evidence where, as here, the parties did not stipulate to the admissibility of the test results and no notice of the administration of the test was given

to the opposing party. *See generally id.* ("[A]dmission of unstipulated results is so rare as to be aberrational"); *Conti v. Comm'r*, 39 F.3d 658, 663 (6th Cir. 1994) ("[U]nilaterally obtained polygraph evidence is almost never admissible under Evidence Rule 403."). We therefore deny the Kabani Respondents' motion to adduce additional evidence, and find no basis for disturbing the hearing officer's credibility determinations.

C. Attempt to repudiate Khan's answer

Respondents argue that Khan's answer, which contains several admissions that helped support findings of liability against all respondents in the hearing officer's decision, should be disregarded. In support of their argument, respondents contend that: (1) Khan was unrepresented by counsel when he filed his answer; and (2) Khan included with the answer a cover letter that should be construed as disavowing the accuracy of Khan's responses.

As to the first contention, it is well settled that proceeding without counsel does not relieve a respondent of the consequences of the representations in his or her filings, even if they could be characterized as mistakes. *See McNeil v. United States*, 508 U.S. 106, 113 (1993) (recognizing need to construe liberally pleadings prepared by pro se prisoners but stating that, in contrast, "we have never suggested that procedural rules in ordinary civil litigation should be interpreted so as to excuse mistakes by those who proceed without counsel"); *Cornejo v. Turks*, 1997 U.S. Dist. LEXIS 1545 at *1 (N.D. Ill. Feb. 5, 1997) ("[T]he solicitude that courts extend to...pro se litigants does not give them a free pass to violate the basic rules of federal pleading." (internal citations omitted)); *Michael A. Rooms*, SEC Rel. No. 34-51467, 2005 SEC LEXIS 728 at *10 (April 1, 2005) (rejecting respondent's argument that the admissions in his answer should be given "minimal weight" because he could not afford counsel and the answer was drafted by a co-respondent's attorney), *aff'd*, 444 F.3d 1208 (10th Cir. 2006).

As to the second contention, the respondents note that Khan's cover letter to his answer stated generically that, "due to the lapse of time between now and [2008], these responses are based solely on the best possible reflection and the documentary and testimonial evidence(s) produced from the initiation of this proceeding up to date. There are chances of errors and omissions in each of these responses and as a result should not be construed as firm responses." Board Rule 5421 requires, however, that an answer shall "specifically" admit, deny, or state that the party does not have, and is unable to obtain, sufficient information to admit or deny "each" allegation in the order instituting proceedings. And if Khan filed his answer in good faith with the incomplete information then available to him but later learned information that rendered admissions he made inaccurate, then he should have timely sought to amend his answer. *See generally Missouri Housing Dev. Comm'n v. Brice,* 919 F.2d 1306, 1314 (8th Cir. 1990) ("'[A]dmissions in the pleadings...are in the nature of judicial admissions binding

upon the parties, unless withdrawn or amended.'" (quoting *Scott v. Comm'r*, 117 F.2d 36, 40 (8th Cir. 1941))). In the absence of any attempt to amend his allegedly inaccurate responses, his admissions may fairly stand. *See generally Davis v. A.G. Edwards & Sons, Inc.,* 823 F.2d 105, 107-08 (5th Cir. 1987) (per curiam) (holding earlier judicial admissions binding, even though admitting party submitted an affidavit at summary judgment that conflicted with earlier statements in his complaint).

The respondents have made no attempt to identify which of Khan's responses were inaccurate, correct them by reference to new evidence, or explain why he could not have given accurate responses in his original filing. And, in any event, it is unlikely that Khan could have made a showing of good cause for failing to correct his supposedly erroneous admissions, as the hearing officer has pointed out that his wholesale attempts to distance himself from his answer are "not credible": at the hearing, when specifically asked whether the responses in his answer were truthful, Khan responded that he simply had "no independent recollection of whether the answers are correct or incorrect." *See* I.D. 57. Under these circumstances, we find no valid basis to disregard Khan's answer. *See, e.g., Columbus Bank & Trust Co. v. McKenzie Trucking & Leasing LLC*, 2009 U.S. Dist. LEXIS 98882 at *22-23 (M.D. Ga. Oct. 23, 2009) (rejecting attempt to disavow admissions in answer where "excuses" for defendant's delay in correcting the alleged inaccuracies, including that he needed additional "'investigation and discovery,'" did not "ring[ ] true").

D. Procedural arguments

The respondents also make several procedural objections to this proceeding, none of which are meritorious. We address each in turn below.

1. Opportunity to present expert witness

The Kabani Respondents argue that the hearing officer improperly denied them permission to present their expert witness of choice when they moved on the eve of trial to introduce a different expert. But their petition fails to acknowledge the considerable accommodations made by the hearing officer to grant the respondents as much latitude as fairly possible in presenting an expert witness for their defense, and we find no error in the hearing officer's decision.

As evidenced in the record, the Kabani Respondents were represented by different counsel when this proceeding was instituted. That counsel was aware by September 2012 that the Division intended to call a data forensics expert. Counsel requested and received two extensions of time from the hearing officer before exchanging expert reports with the Division on November 4, 2012. The Kabani Respondents' expert witness was identified as an individual who had assisted Kabani & Co. in setting up and maintaining their data storage and other computer systems. On

December 24, 2012, the Kabani Respondents unsuccessfully moved to strike the Division's expert's report (on grounds including its "morbid excess") but were granted an extension of time within which to submit a revised expert report responding to the Division's submission. In March 2013 the Kabani Respondents' counsel withdrew from representing them. The Kabani Respondents immediately retained new counsel who, on April 26, 2013 (six weeks before the hearing, which had already been postponed at the new counsel's request), moved for permission to present a different expert.

In denying the motion, the hearing officer noted that the Kabani Respondents, in a declaration supporting the motion, "recognize[d] that their motion is untimely, that the expert-related deadlines have previously been extended 'on several occasions' and that 'prior counsel had an opportunity to identify and present an adequate expert witness to explain the scientific invalidity and deficiencies of the [Division's expert's] Report.'" *See* Order Denying Kabani Respondents' Motion to Present Testimony at the Hearing (May 8, 2013) at 3. Thereafter, the hearing officer made repeated accommodations during the hearing to assist the Kabani Respondents in presenting the testimony of their initial expert, who had then become difficult to reach and unwilling or unable to commit to appear for the hearing. Those accommodations included granting permission to the Kabani Respondents to have their alternate expert attend the hearing during the Division's expert's testimony and serve as consultant to counsel during breaks in questioning. Ultimately, the Kabani Respondents were unable to secure the initial expert's live testimony, but his report stands in the record.

The powers of the hearing officer include "regulating the course of a proceeding and the conduct of the parties and their counsel" and, "subject to any limitations set forth elsewhere in [the Board's] Rules, considering and ruling upon all procedural and other motions." Board Rule 5200(b)(4) & (8). There is no Board rule specifically addressing the standard for deciding whether a hearing officer should accommodate a request to modify an order setting case deadlines, but, in the context of administrative proceedings, courts have recognized generally the "broad discretion [an] agency has in ordering the conduct of its proceedings." *Dearlove v. SEC*, 573 F.3d 801, 807 (D.C. Cir. 2009). We note that Rule 5411 does provide, as to the filing of any papers for which time limits are prescribed by Board rule, that, "[e]xcept as otherwise provided by law," the hearing officer, at any time prior to filing of his or her initial decision, may, "for good cause shown," extend or shorten those time limits. And we further note that courts uniformly recognize that presiding trial judges are authorized to "control and expedite pretrial discovery through a scheduling order." *Buchanan v. Gulfport Police Dep't*, 2011 U.S. Dist. LEXIS 145261, at *2 (S.D. Miss. Dec. 16, 2011). The trial judge is afforded "broad discretion to preserve the integrity and purpose of the pretrial order." *Geiserman v. MacDonald*, 893 F.2d 787, 790 (5th Cir. 1990). Under Federal Rule of Civil Procedure 16(b)(4), which does not apply to PCAOB proceedings but to which we may look for guidance, a party wanting to modify a court's scheduling order (such as one establishing time limits on the introduction of expert witnesses) must show "good cause"

for doing so. F. R. Civ. P. 16(b)(4) (permitting a schedule to be "modified only for good cause and with the judge's consent"). Consistent with that guidance, the hearing officer in this case repeatedly put the parties on notice that scheduling orders would not be modified without "good cause."

The Kabani Respondents were given a considerable amount of time to choose their expert, they made their choice and proceeded with it, and they changed their minds at an unacceptably late hour simply because their new counsel disagreed with previous counsel's strategy. Courts do not accept this as a valid basis for disrupting a fair and reasonable litigation schedule. *See Crandall v. Hartford Cas. Ins. Co.*, 2012 U.S. Dist. LEXIS 173995 at *9 (D. Idaho Dec. 6, 2012) ("A party's dissatisfaction with their expert's opinions and/or an expert's lack of regular and timely communication is an unfortunate circumstance, to be sure....However, the timely progression of a lawsuit cannot turn on whether a party is fully satisfied with the particular choice of an expert. Those are decisions, including the due diligence necessary to guard against difficulties arising from such decisions, that must be made by parties within the scheduling time-frames imposed by the Court."); *see also Adams v. Sch. Bd. of Hanover County*, 2008 U.S. Dist. LEXIS 96296 at *10 (E.D. Va. Nov. 26, 2008) ("The arrival of new counsel... does not entitle parties to conduct additional discovery or otherwise set aside valid and binding orders of the court, regardless of the efficacy of any new strategy counsel seeks to follow."); *Kenny v. County of Suffolk*, 2008 U.S. Dist. LEXIS 93120 at *3 (E.D.N.Y. Nov. 17, 2008) ("Incoming counsel is bound by the actions of his or her predecessor, and to hold otherwise would allow parties to create good cause simply by switching counsel.").

The Kabani Respondents claim that the Division would have suffered no prejudice had they been allowed to belatedly present their new expert. Even if true, however, this is of no assistance to their argument. As courts have held, "the absence of prejudice to the opposing party is not equivalent to a showing of good cause" to modify a scheduling order. *E.g., Wagner v. Circle W Mastiffs*, 2011 U.S. Dist. LEXIS 5663 at *11 (S.D. Ohio Jan. 14, 2011). The respondents were given ample time to identify an expert of their choosing, submit an expert report, revise that report to address the Division's expert's conclusions, and try to secure their expert's testimony at the hearing. They were also given ample opportunity to cross-examine the Division's expert and to consult with another expert of their choosing who was observing the Division's expert's testimony during the hearing. Under these circumstances, we find no basis to conclude that the hearing officer erred in denying the Kabani Respondents' late request to introduce a new expert, and we find no unfairness created by that decision.[2/]

[2/] We note that, even if we were to consider the Kabani Respondents' argument in the context of Federal Rule of Civil Procedure 37(c)(1), which prohibits a party from using witness testimony if the party failed to disclose the witness in a timely manner, the

2. Burdensomeness and hearing officer's level of experience

The Kabani Respondents contend that "the entire process and its result (the Amended Initial Decision) are unfair" in two respects: first, that the "burdens to defend oneself are this extreme," and second, that they were "assigned a hearing officer who has an insufficient understanding of the audit process essential to a fair hearing." We find no merit in these claims of procedural unfairness.

Few respondents, if any, may welcome a regulator's investigation or institution of an enforcement proceeding. But although the Kabani Respondents claim that, over the four years they have defended their case, the Division's "litigation tactics by themselves have practically destroyed the Firm," their allegations of misconduct are not borne out by the record. For example, they protest they were "forced to defend a six day hearing, often lasting until late at night and during the weekend." They fail to acknowledge, however, that the hearing officer extended the hearing into the evenings and the weekend largely to accommodate scheduling requests from the respondents themselves, and only upon agreement by all parties. As another example, the Kabani Respondents take exception to the fact that the hearing officer took ten months to issue his initial decision; yet they do not explain why this delay compels dismissal or how this objection is consistent with their opposition to the Division's motion to expedite our review. There is no evidence that this proceeding was conducted in any manner other than in accordance with the Rules of the Board and other applicable law. The burdens that attend a fairly prosecuted enforcement proceeding are not cause for dismissal.

Moreover, there are no grounds for accusing the hearing officer of lacking the subject matter experience necessary to conduct this proceeding, but we note that, even if such a claim had any basis in fact or law, our de novo review cures the alleged defect. *See Robert M. Fuller*, SEC Rel. No. 34-48406, 2003 SECLEXIS 2041 at *22 n.30 (Aug. 25, 2003), *petition denied*, 95 F. App'x. 361 (D.C. Cir. 2004). Khan, for his part, claims that he was "deprived of the right to due process" because he was asked during his investigative testimony about the version of the Issuer A audit file that Saeed produced

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Kabani Respondents have not shown that their failure to identify their new expert was "substantially justified" or "harmless." *See Hughes v. Stryker Sales Corp.*, 2010 U.S. Dist. LEXIS 47062 at *29-30 n.12 (S.D. Ala. May 13, 2010) (denying plaintiff's request to designate an expert months after discovery had closed and less than three months before trial, finding that the failure to identify an expert sooner was not harmless because, among other things, designating a new expert would "compromise the ... trial setting, and ... guarantee the need for re-open[ing] of discovery, thereby ratcheting up the effort, expense and delay for all concerned based on an expert disclosure matter that plaintiff could and should have addressed some time ago").

but not about the version that Kabani gave to the Division in 2011. When Khan appeared for questioning, however, the Division did not yet have a copy of the file he argues he should have been questioned about, and, to the extent Khan believes he had information about the file relevant to his defense, he does not identify that information or explain how he was prevented from introducing it in this proceeding. We can find no basis for any claim of procedural unfairness.

3. Claims of bias

The Kabani Respondents argue, in a May 27, 2014 motion, that the Board must recuse itself in its entirety from review of the hearing officer's decision because the Board is biased against them. The Kabani Respondents do not specify whether they seek relief in the form of dismissal of this proceeding, review by a differently constituted Board, direct review by the SEC, or other remedy. Because we reject their argument, it is unnecessary to determine the appropriate relief.

The Kabani Respondents contend in their recusal motion that, by accepting Saeed's offer of settlement in May 2013 (just before the hearing in this case commenced), the Board demonstrated that it had already prejudged the case against the remaining respondents. This complaint fails to acknowledge or distinguish authority holding that it is not improper for an administrative body to settle proceedings against one respondent while continuing to proceed against other respondents named in the same case. As the SEC explained in another case in which this complaint was raised:

> Taken at face value, the respondents' arguments suggest that it is virtually impossible for the Commission properly to entertain individual settlements in proceedings involving multiple respondents. Every case involving multiple respondents will ordinarily have some commonality of issues with respect to all respondents, and resolution of one party's case could always be argued to pre-dispose the Commission to a particular version of the facts. However, a policy prohibiting settlements during the pendency of a multi-party proceeding would be contrary to the Administrative Procedure Act ("APA"), 5 U.S.C. § 551 et seq. as well as elementary common sense. The APA prescribes that an agency give all interested parties the opportunity for the submission and consideration of offers of settlement, when time, the nature of the proceeding and the public interest permit. 5 U.S.C. § 554(c)(1). This has been our consistent practice for many years.

The Stuart-James Co., Inc., SEC Rel. No. 34-28810, 1991 SEC LEXIS 168 at *3 (Jan. 23, 1991) (internal footnote omitted). The Board is not bound by the APA, but Board rules provide for the submission of a settlement offer "at any time." *See* Rule 5205(a).

The Board's acceptance of such an offer would impermissibly affect the remainder of the proceeding against other respondents only if the Board "has in some measure adjudged the facts in advance of hearing them." *Stuart-James Co.*, 1991 SEC LEXIS 168, at *5. Our "mere exposure" to the facts of this case in approving Saeed's settlement does not constitute such prejudgment. *Id.; see also Jean-Paul Bolduc*, SEC Rel. No. 34-43884, 2001 SEC LEXIS 2765 at *10-12 (Jan. 25, 2001) (rejecting argument that Commission was biased on grounds that it had accepted an offer of settlement with respondents' former employer and had published findings identical to those made against respondents). The Kabani Respondents concede that the findings against Saeed were expressly limited to the settlement order and are not binding on anyone else. The findings were also neither admitted nor denied by Saeed, consistent with ordinary Board practice in settlement orders. And, as detailed in the amended initial decision, the findings of liability against the Kabani Respondents were grounded on record evidence, not on any finding in Saeed's settlement order. We therefore find no basis to recuse ourselves from deciding this case.

Khan makes a separate argument that this proceeding was conducted in a biased manner. He urges in his petition that the Board should "investigate the prejudice and biased attitude displayed by the [Division] and its employees in this proceeding," contending that he and Kabani, who are of "a particular ethnic group," were treated differently than Deutchman. Khan cites in support of his contention only the fact that he and Kabani were questioned during the hearing for a longer period of time than Deutchman. Our review of the entirety of the record of these proceedings reveals no evidence of inappropriate or illegal conduct by any of the staff, and, as explained in the hearing officer's decision and in this order, the findings of liability and sanctions determinations were made in accordance with applicable law and Board Rules and are well supported by the evidence. We can find no basis to credit Khan's assertion. *See Orlando Joseph Jett*, SEC Rel. No. 34-49366, 2004 SEC LEXIS 504 at *82 (Mar. 5, 2004) (noting that discrimination, if it had occurred in the proceeding, would have been "repugnant and intolerable" but finding respondent's claims thereof "vague and unsubstantiated" and concluding, after "an exhaustive de novo review of the record," that there was "no evidence that this proceeding was tainted by racial animus").

IV. Sanctions

The Kabani Respondents object to the sanctions imposed on them primarily by reiterating their challenges to the findings of liability in the amended initial decision and by pointing to Kabani's polygraph results, which they contend "conclusively refut[e] the propriety of [the] sanction[s]." We have already addressed these arguments above. Khan asserts that the sanctions imposed on him are "completely unfair" but does not provide any specific support for that contention. We conclude that the hearing officer

imposed sanctions that are appropriate for the Rule 4006, AS No. 3, and resulting Rule 3100 violations, reflecting consideration of the nature, seriousness, and circumstances of the violations and any potentially aggravating or mitigating factors suggested by the record, including the state of mind involved in the violations and respondents' respective roles in that misconduct. The inspection process—which is "pivotal to the Board's ability to enhance investor protection and the accuracy of issuer auditor reports through its oversight of registered accounting firms"—would be rendered meaningless if firms were permitted with impunity to whitewash their files in advance of an inspection. *Gately & Assocs., LLC*, SEC Rel. No. 34-62656, 2010 SEC LEXIS 2535 at *3 (Aug. 5, 2010) (sustaining revocation of registration and bar for failure to cooperate with a Board inspection even where there was no evidence of fraud or deceit). Misconduct is especially troubling and deserving of serious sanctions where, as here, respondents went to considerable lengths to conceal their actions and might have been successful in deceiving the Board if Saeed had not reported his concerns.

V. Conclusion

After a de novo review of the record, as well as a review of all of the parties' motions and petitions for review, we therefore summarily affirm the amended initial decision's findings of violation and imposition of sanctions with respect to the respondents' failure to cooperate with a Board inspection, in violation of Rule 4006, respondents' violation of AS No. 3, and their resulting violation of Rule 3100.[3/]

[3/] In addition, as discussed above and in light of our summary affirmance, we deny all motions the parties have filed with us, with the following exceptions. The Division filed a motion to expedite our review, which, for practical purposes, is consistent with our decision to proceed by summary affirmance, and we therefore grant that motion to the extent not inconsistent with this final decision and related order. In concert with its motion to expedite, the Division also filed a motion under Board Rule 5464 to supplement the record with certain publicly available information about Kabani & Co.'s activity related to audit reports for issuers from late 2012 through 2014. In opposing the motion, the Kabani Respondents do not contest the accuracy of this data that the Division gathered from issuer filings with the SEC but do take issue with the Division's interpretation of certain of the data. Leaving aside whether the Division has made the showing described by Rule 5464, we have discretion under that rule to accept the information into the record. Because the information appears to be publicly available information of which the Board could take official notice in any event, because the Kabani Respondents do not contest the accuracy of the data, and because we take into account the Kabani Respondents' arguments about the Division's interpretation of certain of the data, we see no prejudice in allowing the record to reflect the information.

In light of the sanctions that we find appropriate to impose by summary affirmance, we find it unnecessary to consider, and we set aside the initial decision as it relates to, the other violations charged in the order instituting disciplinary proceedings.

Accordingly, it is ORDERED that:

The registration of Kabani & Company, Inc., is permanently revoked;

Hamid Kabani is permanently barred from being an associated person of a registered public accounting firm, and shall pay a civil money penalty of $100,000;

Michael Deutchman is barred from being an associated person of a registered public accounting firm, provided that he may petition the Board to terminate the bar after two years, and shall pay a civil money penalty of $35,000;

Karim Khan Muhammad is barred from being an associated person of a registered public accounting firm, provided that he may petition the Board to terminate the bar after 18 months, and shall pay a civil money penalty of $20,000; and

All respondents are censured.

Each civil monetary penalty shall be paid by (a) United States postal money order, certified check, bank cashier's check, or bank money order, (b) made payable to Public Company Accounting Oversight Board, (c) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006 within 30 days after the effective date, described below, and (d) submitted under a cover letter which identifies the payer as a respondent in these proceedings, sets forth the title and PCAOB File 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.

Effective Date of Sanctions: If a respondent does not file an application for review by the Securities and Exchange Commission (Commission) and the Commission does not order review of the sanctions on its own motion, the effective date of the sanctions shall be the later of the expiration of the time period for filing an application for Commission review or the expiration of the time period for the Commission to order review. If a respondent files an application for review by the Commission or the Commission orders review of the sanction against that respondent, the effective date of

the sanction shall be the date the Commission lifts the stay imposed by Section 105(e) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7215(e).

By the Board (Board Members Ferguson and Hanson not participating)

Phoebe W. Brown
Secretary

January 22, 2015