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Public Company Accounting Oversight Board

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of George W. Stewart, Jr., CPA, Respondent	PCAOB File No. 105-2015-016 **FINAL DECISION** December 15, 2017

Appearances

Michael S. Rosenberg and David C. Ware, Washington, DC, for the Division of Enforcement and Investigations

Carla M. DewBerry, K&L Gates LLP, Seattle, WA, for Respondent

I.

Respondent George W. Stewart, Jr., seeks Board review of the hearing officer's initial decision in this disciplinary proceeding. Stewart served as the engagement partner on the audit of the financial statements of an issuer for the year ended December 31, 2012, and a simultaneous "reaudit" of that issuer's financial statements for the year ended December 31, 2011. Stewart took on that role at the request of a partner at another audit firm who had served as the engagement partner on audits of the issuer's financial statements for more than five consecutive years and had come to understand that, under applicable law, he could not do so for the 2011 and 2012 audits.

The charges against Stewart in this case are primarily that, in leading the 2011 reaudit and the 2012 audit, he failed to exercise due professional care, including professional skepticism; failed to adequately plan and supervise the audits; failed to identify and assess the risks of material misstatement in the audits; and failed to obtain sufficient appropriate audit evidence for significant items reported in the issuer's financial statements. The hearing officer's initial decision found that "[t]he only conclusion that can fairly be drawn from this record is that Stewart agreed to serve as the 'lead partner' for the 2011 Re-Audit and the 2012 Audit 'in name only,'" essentially turning the audits over to a subordinate of the former engagement partner, and in doing so failed to "fulfill any of the responsibilities required of an engagement partner under the applicable PCAOB standards." Index to the Record on Review, Record Document (R.D.) 38, Initial Decision (I.D.) 27. The decision found the record to be "replete with evidence of Stewart's failures to obtain sufficient appropriate audit evidence or perform procedures to address insufficient appropriate audit evidence concerning relevant assertions." I.D. 33. Finding that Stewart's work on the audits was "severely deficient" and that he displayed an attitude of "indifference" to obtaining sufficient audit evidence, the decision concluded that his conduct was reckless, "or, at the very least, involved repeated instances of negligent conduct." I.D. 36, 37. The decision ordered that Stewart be censured, that he be barred from associating with a registered public accounting firm, with leave to petition to associate after three years, and that he pay a $25,000 civil penalty. It also ordered that, upon any re-association, he be restricted for a further two years from serving as an engagement partner or an engagement quality reviewer on issuer audits. Stewart seeks review of all of these determinations.

After *de novo* review of the record, in light of the arguments presented to us, we find that the violations charged are proven by a preponderance of the evidence and we determine that it is appropriate to bar Stewart from association with a registered public accounting firm, with the proviso that he may petition to associate after five years; to censure Stewart; and to order Stewart to pay a $25,000 civil money penalty.

II.

On June 29, 2015, the Board issued an Order Instituting Disciplinary Proceedings (OIP) alleging violations of PCAOB rules and auditing standards by Stewart in conducting a "reaudit" of the fiscal year 2011 financial statements and an audit of the fiscal year 2012 financial statements of Hitor Group, Inc. It is undisputed in this proceeding that at all relevant times Hitor was an issuer, as defined by Section 2(a)(7) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7201(7), and PCAOB rules, and that Stewart was a person associated with George Stewart, CPA (the Stewart Firm), a registered public accounting firm, as defined by Section 2(a)(9) of the Sarbanes-Oxley Act, 15 U.S.C. 7201(9), and PCAOB rules. Stewart answered the OIP on July 31, 2015. Following two days of hearings in February and March 2016, the hearing officer issued an initial decision on September 22, 2016. Stewart petitioned for Board review of that decision, and, on February 9, 2017, briefing on the petition for review concluded. Neither party requested oral argument.

III.

A. Stewart was recruited to serve as engagement partner for the 2011 reaudit and 2012 audit of Hitor and understood that on those audits he was to exercise minimal supervision.

Stewart, a 67-year-old certified public accountant licensed by the Washington State Board of Accountancy since 1982, was the sole owner and partner of the Stewart Firm at all relevant times. R.D. 1, OIP, 1-2 ¶ B.3; R.D. 13, Answer (Ans.) 1, ¶ B.3; Ex. J-54 at 1; Tr. 243-44.[1/] Stewart testified that his firm typically has 15-20 issuer clients at any given time, all of whom "receive going concern opinions," that is, as he described it, audit reports that contain a paragraph "warning [investors] that this company cannot exist for another year without some sort of external intervention" such as "attracting investors" or "attracting additional debt financing." Tr. 59, 61, 246. At the hearing, Stewart declared he had been planning to retire "within two years" and "transition" his business to another CPA, though that process was "going slower than anticipated." Tr. 243-44.[2/]

Stewart became engagement partner on what the parties refer to as the "reaudit" of Hitor's 2011 financial statements and on the audit of Hitor's 2012 financial statements at the request of Thomas Harris, owner of another sole proprietorship in Seattle, Washington, then registered with the PCAOB as Thomas J. Harris, CPA (the Harris Firm). OIP 2, ¶¶ C.1, C.2; Ans. 1-2, ¶¶ C.1, C.2. That firm, with Harris as engagement partner, had audited Hitor's financial statements for every year since the company went public in 2006. Exs. J-1 at 7-8, J-2 at 9, J-3 at 15, J-4 at 16, J-5 at 9-10, J-15 at 10, J-44 at 10-11, J-53 at 11.[3/] Stewart understood during the audits at issue that as engagement partner he was responsible for the engagement and its performance. Tr. 87, 188.

1/ All transcript (Tr.) citations in this opinion are to Stewart's hearing testimony (R.D. 27a and 28a). No other witnesses were called at the hearing.

2/ According to information on the Washington State Board of Accountancy website, of which we take official notice, Stewart's CPA license is currently active, "[l]icensed to practice public accounting" through June 30, 2019. *See* http://apps.cpaboard.wa.gov/Default.aspx?querytype=individual (search: Stewart) (last visited on Dec. 12, 2017).

3/ In June 2015, the Harris Firm and Harris consented, without admitting or denying the allegations, to a Board order imposing sanctions on the basis of Board findings that they violated PCAOB rules and standards in connection with the audits of Hitor and two other issuers. *Harris & Gillespie CPA's, PLLC, and Thomas J. Harris, CPA*, PCAOB Rel. No. 105-2015-011, at 7-13 (June 16, 2015). The order imposed a $15,000 civil penalty on the Harris Firm, revoked its registration with leave to reapply after five years, censured both respondents, and barred Harris from association with a registered public

During the pertinent period, in filings with the Securities and Exchange Commission (Commission or SEC), Hitor, a Nevada corporation headquartered in Kirkland, Washington, described itself as a "development stage company with limited operations, limited revenue, limited financial backing and limited assets" that owned proprietary technology to increase vehicle fuel efficiency. OIP 2, ¶ C.3; Ans. 2, ¶ C.3. In each of its annual reports since 2006 Hitor stated there was "substantial doubt about [the company's] ability to continue as a going concern." Ex. J-15 at 9; Tr. 61. Its common stock was quoted on the OTC Bulletin Board. OIP 2, ¶ C.3; Ans. 2, ¶ C.3; Ex. J-44 at 6.

Stewart testified that he "had worked with Tom Harris for a number of years," with Harris "primarily" serving as concurring reviewer for Stewart's audits. Tr. 44. In early 2013, as Harris was preparing to audit Hitor's 2012 financial statements, the PCAOB inspection process brought to Harris's attention that, in Harris's words, he had "reached or passed the required 5 year limit" for three of his 17 issuer clients, including Hitor. Ex. J-23 at 1; *see* Ex. J-25 at 2; Ex. J-26.[4/] After communicating with Hitor about the situation, the Harris Firm retained the Hitor engagement, with Harris and Stewart agreeing that Stewart would serve as engagement partner for the audit of Hitor's 2012 financial statements and simultaneous reaudit of its 2011 financial statements. *See* OIP 4 ¶ 10; Ans. 2 ¶ 10 (Stewart admits, "In early 2013, while preparing for the audit of Hitor's FY 2012 financial statements, the [Harris] Firm and Harris determined that they might not be independent of Hitor, and might not have been independent of Hitor for the FY 2011 audit, because the FY 2011 audit had been the sixth consecutive audit for which Harris had acted as lead partner. In response, Harris asked Stewart to serve as partner for the audit of Hitor's FY 2012 financial statements, and simultaneously to conduct a 're-audit' of Hitor's FY 2011 financial statements.").

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accounting firm, with leave to petition to associate after five years. *Id.* at 16-17. The order stated, "The findings herein are made pursuant to Respondents' Offers and are not binding on any other person or entity in this or any other proceeding." *Id.* at 2 n.3.

[4/] Section 10A(j) of the Securities Exchange Act of 1934, 15 U.S.C. 78j-1(j), provides that "[i]t shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer." The Commission has incorporated this restriction into its auditor independence rules, which provide that (subject to an exception that did not apply to the Harris Firm), an audit firm is not independent of an audit client when an audit partner performs the services of lead partner for more than five consecutive years. Rule 2-01(c)(6)(i)(A)(1) of Commission Regulation S-X, 17 C.F.R. 210.2-01(c)(6)(i)(A)(1).

Stewart testified that he could not recall the specific date on which he made that agreement with Harris. Tr. 44-45. In a letter dated March 26, 2013, copied to Stewart, however, Harris represented to Hitor's Board of Directors that, "As a result of the partner rotation requirement, Thomas J. Harris, CPA is no longer independent. In his place, George Stewart, CPA will be acting as the partner in charge and accordingly has no independence issues involving your Company." Ex. J-28 at 5.

At the hearing, Stewart stated that he and Harris "had a couple of conversations" about Stewart's assumption of the role of engagement partner. Tr. 44. From these conversations, Stewart understood that Hitor would remain a client of the Harris Firm. Tr. 49-50. Stewart testified that he "did in fact do some concurring reviews for Hitor" in the past, so that he "was familiar with how [Harris] prepared work papers and…so [he] didn't think it would be a stretch to be an engagement partner." Tr. 239. The engagement team for both audits would consist solely of Stewart, as engagement partner, and a staff employee of the Harris Firm (Staff Employee), as audit manager. Tr. 20, 29, 39. Stewart understood that Harris had arranged for another licensed CPA to perform the engagement quality reviews on the audits. Tr. 242; *see* Ex. J-23; Ex. J-32.

Stewart also testified that Harris was planning to "develop" Staff Employee into a "second partner" as a "long-term solution" to the recurring problem of complying with the five-year partner rotation rule with respect to Hitor and the Harris Firm's other issuer clients. Tr. 49-50. Stewart had never previously worked with or supervised Staff Employee on an audit engagement and knew nothing about Staff Employee's qualifications as an auditor other than that Staff Employee was licensed as a CPA and worked at the Harris Firm. Tr. 21, 181. Nonetheless, Stewart testified that from his conversations with Harris he understood that for each of the two audits, "the idea was I would have a minimal amount of supervision [over Staff Employee] because [Harris] wanted [Staff Employee] to take over executing the audit." Tr. 73, 180-81, 217-18. Stewart and Harris "planned all along" that Staff Employee would "do as much of the audit as possible" and "work with the audit programs and it was [Staff Employee's] responsibility to run with it," with "minimal supervision" from Stewart. Tr. 48, 217-18. As Stewart explained several times at the hearing, the "idea" or "plan" for each audit was "to have [Staff Employee] do as much as possible in his audit without direct supervision from me," to give Staff Employee, in other words, "as much latitude as possible to see whether he can do the audit without a great deal of supervision," while Stewart played only a "very minimal" role, and Stewart testified that "we did in fact execute that plan" during the 2011 reaudit and the 2012 audit. Tr. 39-40, 49, 180-81, 72-73, 217-18.

Additionally, Stewart testified that as to both the 2012 audit and the 2011 reaudit, he understood that although "there's going to be communication" to some extent between Harris and Hitor, Harris "could not participate in the audit because…he was over the five year limit to act as an engagement partner for the audit." Tr. 29, 32-34 ("He can't work on the audit…he couldn't perform any of the work paper documentation and he couldn't sign off on any of the programs…he didn't sign off on anything approving anything and he certainly didn't do any of the work papers."). As to communication, on April 3, 2013, Harris sent an email to Hitor management (copying Stewart) requesting online access to the company's bank accounts, asking for its "stance" on whether it intended to "write off the inventory," and asking for a meeting between management and Staff Employee so that Staff Employee could collect documents necessary to the audit work. Ex. J-32 at 1. Harris also appears to have approved at least three documents in the work papers: an incomplete "Engagement Completion Document" in the 2011 reaudit work papers that bears Harris's signature as "Engagement Partner" (Ex. J-10 at 14) and the first page of an "Audit Program for Cash," included in both sets of work papers, that bears Harris's initials. *See* Ex. J-10 at 103, Ex. J-17 at 68. Consistent with Stewart's minimalist, hands-off approach to the audits, and despite his responsibility as engagement partner for the assignment of tasks to audit assistants (*see* AU § 230.06), he did not ask Harris or Staff Employee whether Harris was taking any other actions related to the audits (Tr. 34), there is no evidence in the record that Stewart otherwise took any steps to find out, and he does not claim to have questioned Harris about the three documents, which seem on their face to conflict with Stewart's stated understanding of Harris's limited role in light of the auditor rotation requirement.

B. By design, Stewart played no role in the planning or execution of the 2011 reaudit or the 2012 audit.

Stewart testified that Staff Employee performed all planning and risk assessment procedures for both the 2011 reaudit and the 2012 audit. Tr. 40, 49, 75, 90, 179-80, 184, 188-90. Staff Employee (and, as noted above, sometimes Harris) communicated directly with Hitor management to obtain documents and information for the audit, and Staff Employee performed all of the audit procedures and prepared the work papers for both of the audits himself. Ex. J-10 at 24-48; Ex. J-17 at 29-53; Ex. J-28; Tr. 38-41. By Stewart's own account at the hearing, for both audits his supervision of Staff Employee consisted solely of reviewing emails on which Staff Employee copied him and reviewing the work papers after Staff Employee prepared them. Tr. 71. Stewart also testified that he did not himself "send any e-mails to [Staff Employee] regarding this audit" and could not recall any phone conversations or meetings with him during the audits. Tr. 48-50.

More specifically, Stewart did not discuss with Staff Employee his responsibilities for performing the audits, did not participate in the planning of the audits, did not participate in the development of an audit plan or strategy, and did not direct Staff Employee to bring any significant accounting or auditing issues to Stewart's attention. Tr. 74-75, 182-84. Stewart admitted that "there was no formal planning session where we sat down and we went over and formalized any audit record or discuss[ed] the audit plan" because "Mr. Harris'[s] idea" "was to have [Staff Employee] do as much as possible in his audit without direct supervision from me." Tr. 49. Stewart testified that he understood that Staff Employee would be using "generic" audit programs, a "common procedure" among "smaller firms," and that he expected Staff Employee to tailor them as necessary to the Hitor audits. Tr. 38, 40. Stewart stated that "the planning procedures are to examine the generic programs that are necessary to conduct an audit and then turn them over to, in this case, [Staff Employee]." Tr. 39. But Stewart conceded that the predicate task of identifying the appropriate audit programs and procedures to use also fell to Staff Employee: "Well, yeah, that's part of the process. You want to see his ability to pick the appropriate programs and to decide which appropriate work papers to gather in order to complete the audit. That's part of the training process and can he handle it. And you turn over a set of generic programs and can he complete the audit. That's what you're looking for." Tr. 40. Stewart operated on the assumption that Staff Employee "was expect[ed] to know" which procedures the audits called for. Tr. 72.

Without input or direction from Stewart (Tr. 75, 184), Staff Employee assessed the risk of material misstatement for all accounts relevant to this proceeding in both audits as "low" (Ex. J-10 at 246, 248; Ex. J-17 at 222-23).[5/] In support of these risk assessments, Staff Employee obtained: (1) a two-page "Fraud Awareness Questionnaire," which was signed by Hitor's chief executive officer (CEO) on March 27, 2013 and consisted of a check mark or "x" by the CEO in "yes," "no," or "N/A" columns next to 26 pre-printed questions; and (2) a one-page "Analysis of Internal Controls for the year ended December 31, 2012," a form that was completed and on April 2, 2013 provided to Staff Employee by the CEO and in which the CEO wrote "we have no employees" near the top and his own name under "Employees" next to ten pre-printed items or factors under "Cash Receipts" (*e.g.*, "Receives checks"), eight under "Disbursements" (*e.g.*, "Prepares checks"), and eight under "Miscellaneous" (*e.g.*, "Has password to general ledger"). Staff Employee included identical copies of the Questionnaire and the Analysis of Internal Controls in the work papers for both the 2011 reaudit and the 2012 audit. Ex. J-10 at 243-45; Ex. J-17 at 219-21. Nothing in the work papers suggests Staff Employee performed any audit procedures on these documents. *See* Ex. J-10 at 243-45; Ex. J-17 at 219-21; Tr. 91-92. Stewart testified he was aware that Staff Employee did nothing with the documents except receive them and place them in the work paper files. Tr. 97.[6/]

[5/] The two areas assessed as presenting a "moderate" risk were Income & Expense and Commitments. Ex. J-10 at 246, 248; Ex. J-17 at 222-23.

[6/] On the Analysis of Internal Controls form, Hitor's CEO stated that the company had "no employees." Ex. J-10 at 245; Ex. J-17 at 221. This conflicted with the statement in Hitor's draft Form 10-K, a copy of which was included in the 2011 reaudit work papers, that Hitor employed a sales manager. Ex. J-10 at 329. The work papers Staff Employee prepared and Stewart reviewed did not document that Staff Employee noticed or followed up on this discrepancy, nor is there any indication in the record that Stewart

Stewart reasoned that "you wouldn't normally follow up" on this information because "the purpose of those two documents is to assess how much reliance you're going to place on the controls that the company has in place," and he understood that "with [a] development stage company with no employees, as a practical matter, you can't put any reliance on the controls." Tr. 92-93. Yet he did not discuss with Staff Employee how this or any other aspect of Hitor's business environment or controls could affect Staff Employee's work. Tr. 74-75, 183. For both audits, Staff Employee worked on his own to set planning materiality at $12,000 with a "tolerable misstatement" level of $9,000. Ex. J-10 at 251; Ex. J-17 at 227; Tr. 180. As discussed below, all assertions in the financial statements for which insufficient supporting evidence was obtained involved dollar amounts that significantly exceeded the thresholds Staff Employee set.

C. Stewart failed to identify or attempt to understand or resolve several deficiencies and discrepancies in both sets of audit work papers.

Stewart began his review of the work papers for both the 2011 reaudit and the 2012 audit the day before Hitor intended to file with the SEC a Form 10-K that included in one document a reissuance of the 2011 financial statements and a first-time issuance of the 2012 financial statements. Tr. 51-52; *see* Ex. J-44 at 12. During April 15 and 16, 2013, Stewart spent a total of four hours, combined, reviewing the work papers for both of the audits. Ex. J-49; Tr. 51-54. He did not contact Staff Employee with any questions before signing off on Staff Employee's work. Tr. 73. The work papers for both audits, however, contain several significant deficiencies and discrepancies that Stewart did not identify or attempt to resolve, as detailed below.

1. Deficiencies and discrepancies in the 2011 reaudit work papers

In his review of the work papers for the 2011 reaudit, Stewart failed to identify or try to understand or resolve deficiencies and discrepancies in the work papers related to assertions in the financial statements as to both assets (including cash and inventory) and liabilities (including convertible notes payable, a deposit, and notes payable).

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noticed or followed up on it. *See, e.g.,* Tr. 94-97. The draft Form 10-K in the work papers is likewise internally inconsistent on this point. On the same page of the 10-K, the company represents both that it "hope[s] to hire [a] sales representative in the next 12 months who will work with our sales manager," and also that, "[o]ther than Hitor's Directors and Executive Officer, who are currently donating their time to the development of the company, there are no employees of Hitor Group." Ex. J-10 at 329. The inconsistency carried through to the final version of the Form 10-K. Ex. J-44 at 4, 5.

a. Assets: cash

On its balance sheet Hitor reported a cash balance of $109,402 as of December 31, 2011, which represented more than 59% of Hitor's total reported current assets of $185,370. Ex. J-44 at 12. Stewart believed that Hitor's cash was a material item on its balance sheet. Tr. 69. The risk planning work paper that Staff Employee created for the 2011 reaudit indicated that, in order to "minimize risk," Staff Employee would "[a]nalyze client's bank reconciliations and confirm directly with the bank." Ex. J-10 at 246. Staff Employee, however, prepared but did not send a confirmation request to Hitor's bank. Ex. J-10 at 364; Tr. 146-47. Instead, notations in the work papers indicate that Staff Employee compared bank statements that Hitor provided to Staff Employee with Hitor's accounting ledger and with select lines in Hitor's trial balance for the two of Hitor's cash accounts with the largest balances. Ex. J-10 at 107, 365-96; Tr. 147-51.

As noted above, on April 3, 2015, almost two weeks before Stewart reviewed Staff Employee's work, Stewart had been copied on an email that Harris sent to Hitor management stating, "I don't seem to be able to get online to view the bank accts" and asking management for help in gaining online access to them. Ex. J-32 at 1. There is no evidence of a response in the record, and Stewart testified that he did not recall any later correspondence on the issue. Tr. 155. There is no indication in the record that Stewart took any steps to learn whether or how the problem was resolved, that is, to ascertain whether Staff Employee was able to obtain the bank statements directly from the bank or otherwise determine that those statements were reliable as audit evidence. Staff Employee did not include in the work papers copies of the bank statements he had inspected, and Stewart admittedly took no steps to inspect the bank statements himself. Tr. 151. Stewart did not discuss with Staff Employee whether there were any indications that those statements were illegitimate or had been altered. Tr. 151.

Staff Employee's documentation of his work to compare the bank statements to Hitor's accounting ledger indicates his work was incomplete. Specifically, he noted that a bank statement for Hitor's largest bank account agreed with Hitor's cash subledger for that account as of Tuesday, December 27, 2011 (Ex. J-10 at 395-96; Tr. 153-54) and that the bank statement for Hitor's second-largest account agreed with the cash subledger as of Thursday, December 29, 2011 (Ex. J-10 at 391-92; Tr. 151-53). But Stewart conceded there is no evidence in the work papers that Staff Employee did any audit work to address the intervening period between those confirmation dates and the December 31, 2011 balance sheet date on which the aggregated balance of these accounts was reported. Tr. 153. Stewart did not himself perform any procedures on Hitor's reported cash balance as of December 31, 2011. Tr. 150-51. He signed off on Staff Employee's work without comment or question. Ex. J-10 at 1; Tr. 71-76.

b. Assets: inventory

On its balance sheet Hitor reported inventory of $75,968 as of December 31, 2011, which represented over 40% of its total reported assets. Ex. J-44 at 12. Stewart believed that inventory was a material item on Hitor's balance sheet for the 2011 reaudit. Tr. 70. The risk planning work paper in the record indicates that, to "minimize risk," Staff Employee would "obtain confirmation" of the inventory. Ex. J-10 at 246.

The 2011 work papers contain a spreadsheet prepared by Hitor that, among other things, indicated that there was no change in the amount of Hitor's reported inventory from year-end 2010 to year-end 2011. Ex. J-10 at 256-57; *see* Tr. 133. On March 26, 2013, Staff Employee sent an email to Hitor, with a copy to Stewart, requesting certain information including support for Hitor's valuation of inventory, stating, "Inventory hasn't changed for several years. Do you have any documentation to provide us with that supports the value of $75,968?" Ex. J-34 at 1. The record contains no response from Hitor, and, as Stewart conceded, the 2011 reaudit work papers do not document any procedures performed by Staff Employee or Stewart to test the valuation of the inventory Hitor was reporting as of December 31, 2011. Tr. 133-35.

Stewart knew when reviewing the 2011 reaudit work papers that Hitor would be writing off the entire value of the inventory to $0 on its 2012 financial statements. Ex. J-44 at 12; *see* Tr. 203. Stewart conceded that he did not consider whether Hitor's write-off of its inventory in 2012 suggested that the 2011 amount for inventory on Hitor's balance sheet might have been materially misstated, asserting that "primary responsibility for the financial statements rests with the client." Tr. 139-40.

Stewart also testified that, because of Hitor's planned write-off of its inventory, he did not consider it necessary to perform any procedures to confirm the existence of the inventory for the 2011 reaudit. The original 2011 audit performed in early 2012 seems to have involved a physical count of the inventory. Ex. J-11 at 55. But the 2011 reaudit work papers contain no evidence of whether Staff Employee or Stewart considered that count as evidence for their own audit or considered whether it would be appropriate to rely on the original 2011 audit work in lieu of performing their own procedures. To the contrary, Stewart testified during the hearing that he "didn't consider" whether he needed to perform his own count during the reaudit. Tr. 206. He conceded that such a count would have been "possible," but, he testified, "since we knew it was going to be written off [in 2012], why would we go back and do that?" Tr. 207. According to Stewart, "These are pretty small audits and…as a practical matter you're not going to spend a lot of time counting things that you are not going to put on the balance sheet. You don't have a lot of time to waste on these things." Tr. 206. Stewart signed off on Staff Employee's work without comment or question. Ex. J-10 at 1; Tr. 73.

c. Liabilities: convertible notes payable, deposit, and notes payable

As of December 31, 2011, Hitor reported on its balance sheet current liabilities of $805,983, including, among other things, convertible notes payable of $400,000, a deposit of $150,000, and notes payable of $81,270. Ex. J-44 at 12. Together these items represented about 78% of its total reported liabilities (and individually, 49%, 19%, and 10%, respectively). *Id.* Stewart believed that each of these amounts was material to Hitor's 2011 balance sheet. Tr. 70-71. The risk planning work paper in the record indicates that, to "minimize risk," Staff Employee would "review contracts and detailed schedules" for convertible notes and "trace to details" the deposit. Ex. J-10 at 246.

On April 13, 2013, Staff Employee had emailed Hitor's accountant, with a copy to Stewart, pointing out that, as to the $400,000 in convertible notes payable and $150,000 deposit, "[t]hese are old and I have no idea what for." Ex. J-36 at 2. Stewart never learned whether Staff Employee received an explanation of these liabilities. Tr. 107-08.

The audit program in the work papers (Ex. J-10 at 173-77, "Audit Program for Notes Payable and Long-term Debt") indicates that Staff Employee was to use "an analysis of the notes payable, long-term debt, capitalized lease obligations, and other financing transactions or arrangements such as lines of credit," and "[t]est the clerical accuracy of the analysis," "[t]race the opening balances to the adjusted prior year working trial balance and the ending balances to the current-year working trial balance," and "[r]eview any reconciliation to the general ledger and investigate any unusual reconciling items." Ex. J-10 at 174. Stewart testified that "you're supposed to execute…the steps articulated in the program and then you have references to where you actually did that work," noting that the program references a schedule designated "A55." Tr. 103 (citing Ex. J-10 at 174); *see* Ex. J-55 at 1 (index of Hitor audit work papers). That schedule, a short, client-prepared spreadsheet listing the company's assets and liabilities with some notations made by Staff Employee and bearing his initials (Ex. J-10 at 256-63), does not demonstrate that any procedures were performed to test any of these reported liability items—the $400,000 convertible notes payable, the $150,000 deposit, or the $81,270 notes payable. *See* Ex. J-10 at 258-59, line 49 (listing $400,000 in notes payable with no comments or notations), line 50 (listing deposit of $150,000 with no comments or notations), lines 51-54 (listing total of $105,770.28 in three separate loans payable with no comments or notations). Stewart signed off on Staff Employee's work without comment or question. Ex. J-10 at 1; Tr. 71-76.

d. Management representation letter and response to management inquiry of the company's lawyer

Obtaining written representations from company management, as well as requesting that management send a letter of inquiry to the company's lawyers with whom management consulted concerning litigation, claims, and assessments, for the year under audit, are presumptively mandatory audit procedures and were listed in the 2011 reaudit work papers as the first two audit tasks to perform.[7/] Both Staff Employee and Stewart indicated in those work papers that they reviewed Hitor's management representation letter and the response to management's inquiry of Hitor's outside lawyer (referred to in the work papers as a "legal representation" letter). Ex. J-10 at 1, 17, 18.

The management representation letter was intended to serve as the company's confirmation to its auditors that, among other things, the financial statements "are fairly presented in conformity with U.S. generally accepted accounting principles," that the company has made available to its auditors "all [f]inancial records and related data," and that management has no knowledge of "any fraud or suspected fraud affecting the [c]ompany." *Id.* at 9. The "legal representation letter" was meant to inform the auditors of any "pending or threatened litigation, claims, and assessments." *Id.* at 11.

Yet the management representation letter in the 2011 reaudit work papers states that it was provided "in connection with [the] audit of the balance sheet of [Hitor] as of December 31, 2012," not the reaudit of the financial statements for the period ending December 31, 2011. *Id.* at 9-10 (schedule A01). Those work papers include a copy of

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[7/] *E.g.*, AU § 333.01, *Management Representations* ("This section establishes a requirement that the independent auditor obtain written representations from management as a part of an audit of financial statements performed in accordance with generally accepted auditing standards and provides guidance concerning the representations to be obtained."), .05 ("Written representations from management should be obtained for all financial statements and periods covered by the auditor's report."); AU §§ 337.06, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* ("the auditor should request the client's management to send a letter of inquiry to those lawyers with whom management consulted concerning litigation, claims, and assessments"), .08 ("A letter of audit inquiry to the client's lawyer is the auditor's primary means of obtaining corroboration of the information furnished by management concerning litigation, claims, and assessments."), but a lawyer's "refusal to furnish the information requested" in an inquiry letter "would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion."), .13 (a lawyer's "refusal to furnish the information requested" in an inquiry letter "would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion"); PCAOB Rule 3101(a)(2) (explaining that a PCAOB auditing standard that uses the word "should" imposes a responsibility that is "presumptively mandatory," meaning that failure to discharge it "is a violation of the relevant standard and Rule 3100" unless the auditor "demonstrates that, in the circumstances, compliance with" that responsibility "was not necessary to achieve the objectives of the standard" and that "alternative actions he or she followed in the circumstances were sufficient to achieve [its] objectives"); Ex. J-10 at 1; Ex. J-17 at 1.

an unanswered request from Hitor to its outside lawyer for a letter concerning litigation, claims, and assessments in the course of "an audit of our financial statements for the year ended December 31, 2012" (*id.* at 7-8 (schedule A03)), but no request for the year ended December 31, 2011. A response letter from the outside lawyer appears in the 2012 work papers, but, consistent with Hitor's request, the letter states it was provided by counsel "in connection with [the] examination of [Hitor's] accounts as of December 31, 2012," not as of the end of 2011. Ex. J-17 at 15-16 (schedule A03).

Stewart conceded that neither a management representation letter for 2011 nor a lawyer response letter for 2011 appears in the 2011 reaudit work papers. Tr. 162. When asked if Hitor requested a lawyer response letter for the 2011 reaudit, Stewart testified, "I don't know, but certainly in that case if it was, it would be in the previous work papers and there would be little point of asking on December 31st of 2012." Tr. 156. But no lawyer response letter exists in Harris's original 2011 audit work papers, and Stewart could not recall ever seeing such a letter. Ex. J-6; Tr. 157-58. Even so, Stewart signed off on Staff Employee's work. Ex. J-10 at 1; Ex. J-47 at 1.

2. Deficiencies and discrepancies in the 2012 audit work papers

In his review of the work papers for the 2012 audit, Stewart failed to identify or attempt to understand or resolve the following deficiencies and discrepancies in the work papers related to assertions in the financial statements as to both assets (including inventory, prepaid expenses, and transactions involving a Hitor Poland) and liabilities (including convertible notes payable and notes payable).

a. Assets: inventory

As noted above, Hitor wrote off its inventory during 2012, and reported $0 as the value of inventory on its balance sheet as of December 31, 2012, compared to $75,968 as of December 31, 2011. Ex. J-44 at 12; Tr. 203. This reduced Hitor's reported assets by over 30% for 2012. Ex. J-44 at 12. Stewart considered Hitor's write-off of its inventory to be a material event for Hitor's 2012 financial statements. Tr. 178. As in the 2011 reaudit, the risk planning work paper for the 2012 audit indicates that, to "minimize risk," Staff Employee would "obtain confirmation" of the inventory. Ex. J-17 at 222.

Stewart understood that Hitor had no sales in 2011 or 2012. Tr. 203. In the April 3, 2013 email from Harris to Hitor management discussed above (on which Stewart was copied), Harris was still asking for Hitor's "stance" on whether it intended to write off the inventory. Ex. J-32 at 1. No response appears in the record. As Stewart understood it, "The write[-]off was suggested by [the] CPA who was preparing the financial statements and the question was raised whether or not that should be written off and that was a decision that was made." Tr. 203. No audit procedures were performed to determine whether that decision was appropriately applied to the 2012 financial statements or should have been applied to the 2011 financials. Tr. 203-04. In fact, the work papers for the 2012 audit relating to inventory show, without comment or notation, that the inventory amount for 2012 was $75,958, not $0. *See* Ex. J-17 at 232-33, line 17). Further, neither Staff Employee nor Stewart tried to confirm the existence of the inventory being written off in 2012 (nor had they done so for the 2011 reaudit, as discussed above) because Stewart believed a count of inventory intended to be written off would have been "kind of a moot point." Tr. 206-07. Stewart signed off on Staff Employee's work without comment or question. Ex. J-17 at 1; Tr. 71-76.

b. Assets: prepaid expenses

Hitor reported a current asset of $57,617 in prepaid expenses on its balance sheet as of December 31, 2012, which did not appear on the balance sheet as of December 31, 2011. Ex. J-44 at 12; Tr. 203. This item comprised 47% of Hitor's total reported current assets for 2012 (and 40% of its total assets for 2012). Ex. J-44 at 12. Stewart considered the $57,617 in prepaid expenses to be material to Hitor's balance sheet at the time of the 2012 audit. Tr. 178.

The risk planning work paper in the record states that, to "minimize risk," Staff Employee would "review [the] contract" related to $144,043 in total "prepaid consulting expenses." Ex. J-17 at 222. He wrote in the work papers that the "contract" can be found in the "perm" (permanent client file) as schedule "F275." Ex. J-17 at 94; *see* J-17 at 233, line 18 (on client-prepared spreadsheet next to $144,042.72 prepaid expenses line item, Staff Employee noted, "They entered into a marketing agreement. F275"). A contract, dated March 2, 2012, between Hitor and a consulting firm for marketing work is included in the record, but it is unsigned and bears no indication of how the agreement for services supports the amount Hitor reported for prepaid expenses on its balance sheet. Ex. J-57 (client permanent file) at 516-17. There is no documentation in the work papers of any additional audit procedures performed to test the existence or valuation of prepaid expenses in Hitor's 2012 financial statements. Stewart signed off on Staff Employee's work without comment or question. Ex. J-17 at 1; Tr. 71-76.

c. Assets: investment in Hitor Poland

Hitor reported $23,100 as an "Investment in Hitor Poland LLC" under "other assets" on its balance sheet as of December 31, 2012. Ex. J-44 at 12. This amount represented all assets in the "other" category and 16% of Hitor's total reported assets. *Id.* In the 2012 audit, Stewart believed that the investment of $23,100 in Hitor Poland LLC was material to Hitor's balance sheet. Tr. 178-79. The risk planning work paper in the record indicates that, to "minimize risk" related to the $23,100 reported as "Other Current Assets," Staff Employee would "[t]race to details and invoice." Ex. J-17 at 222.

The work papers for the 2012 audit indicate that Hitor had issued checks from one of the company's bank accounts for $3,000 on May 14, 2012, to Hitor Poland LLC, a "new company," and for $20,100 on September 13, 2012, to a company called "Vbine" to "buy wind turbine for Poland." Ex. J-17 at 331 (schedule F240); *see also* Ex. J-17 at 309 (schedule F114), line 567; Ex. J-17 at 323 (schedule F114), line 897. Staff Employee documented that he "traced" the total $23,100 amount to an invoice. Ex. J-17 at 233 (schedule A55). That invoice, prepared by Hitor and initialed by Staff Employee, indicates that a company called Vbine Energy, in Canada, sold a wind turbine for $20,100 to Hitor on August 23, 2012, and that the item was to be shipped to Hitor's office in Kirkland, Washington. Ex. J-17 at 332 (schedule F240.1); Ex. J-55 at 2 (work paper index). The invoice did not refer to Poland or to Hitor Poland, nor does it mention or otherwise appear to support the earlier payment of $3,000. Stewart testified that he did not know what Hitor Poland was but that Hitor itself was a "development stage company and they try any number of things" and "s[o] it's not unusual they would try a new investment opportunity." Tr. 208. The work papers for the 2012 audit do not document that Staff Employee performed any audit procedures regarding the purchase of the wind turbine other than obtaining a copy of the Hitor-prepared invoice and including it in the work papers. Tr. 210-11. Neither Staff Employee nor Stewart documented any inquiry made of Hitor as to how a purchase of a wind turbine bought from a Canadian company and shipped to Washington State might relate to an investment in a company in Poland. Despite the discrepancies, Stewart signed off on Staff Employee's work without comment or question. Ex. J-17 at 1; Tr. 71-76.

d. Liabilities: convertible notes payable and notes payable

Hitor reported convertible notes payable of $487,019 and notes payable of $168,662 as current liabilities on its balance sheet as of December 31, 2012. Ex. J-44 at 12. These amounts represented, respectively, 48% and 17% of Hitor's total reported liabilities (combined, 65%). At the time of the 2012 audit, Stewart believed that both the convertible notes payable of $487,019 and the notes payable of $168,662 were material to Hitor's balance sheet. Tr. 179. The risk planning work paper in the record indicates that, to "minimize risk" related to the reporting of convertible notes payable, Staff Employee would "[r]eview contracts and detailed schedules." Ex. J-17 at 222.

The work papers for the 2012 audit contain two different amounts for Hitor's liability for convertible notes payable: one for $762,647 (Ex. J-17 at 222-23) and another for $400,000 (Ex. J-17 at 235). Both of these amounts are materially different from the $487,019 reported in Hitor's financial statements. Tr. 222.

At the hearing, Stewart was unable to explain how the documentation in the work papers supported the amount of the convertible notes payable reported in the financial statements. Instead, he testified that the work papers contained cross-references to schedules that Stewart had reviewed and "where you would expect to find the support [for the $487,000]," but "[i]t's never going to be a one-for-one." Tr. 225-27. The schedules Stewart pointed to at the hearing contain no documentation of any audit procedures performed to test the reported figure of $487,000 for convertible notes payable. *See* Ex. J-17 at 252-275 (schedule B10, consisting of the firm's audit opinion and copies of Hitor's financial statements); Ex. J-17 at 276-77 (schedule C20, showing figure of $400,000 for convertible notes payable and referring to schedule F302 (Ex. J-17 at 333-34, also showing trial balance of $400,000)); Ex. J-17 at 282-329 (schedule F114, spreadsheet documenting testing of cash balances unrelated to the reported convertible notes payable); *see also* Ex. J-17 at 234-36 (schedule A55, showing $400,000 figure, unannotated). A note to the financial statements regarding the reported figure for convertible notes payable discusses various note purchase agreements and other transactions entered into by the company. Ex. J-44 at 19. Although these agreements appear to be included as part of the auditor's permanent file for the company, *see* Ex. J-57, there is no evidence in the work papers that Staff Employee inspected those agreements as part of any effort to determine whether the agreements supported the amount reported in the financial statements, and Stewart testified that he did not review the agreements himself. Tr. 230.

Similarly, the 2012 audit work papers do not document any audit procedures performed related to the notes payable of $168,662 reported on Hitor's balance sheet as of December 31, 2012. At the hearing, Stewart could not explain how the figure was tested. Tr. 227-29; *see* Ex. J-17 at 234-35. Related to the that figure, Hitor disclosed in footnote 8 to its 2012 financial statements that one of its notes payable was "secured by inventory." Ex. J-44 at 19. Staff Employee did not document any procedures performed to ascertain what impact Hitor's write-off of its inventory during 2012 might have on the relevant assertions of notes payable, one of which notes was secured by inventory that was now valueless, and Stewart testified that he made no such assessment himself. Tr. 231-32. Stewart signed off on Staff Employee's work on these reported liabilities without comment or question. Ex. J-17 at 1; Tr. 71-76.

D. Stewart signed off on the work papers for both audits and Hitor filed its Form 10-K containing both sets of financial statements and the audit report, in the name of the Harris Firm, on those financial statements.

On April 15, 2013, after performing the field work and preparing the work papers for the 2011 reaudit and the 2012 audit, Staff Employee notified Stewart that the work papers were available to review remotely using Dropbox, an internet-based file storage and sharing service. Ex. J-47 at 4-5; Tr. 51-53. Stewart testified he began his review of the work papers that day, spending a total of four hours on the review. Tr. 51-54; *see* Ex. J-49 at 1. As noted above, he did not contact Staff Employee with any questions about the audit planning or procedures performed. Tr. 73. Stewart emailed Harris on

April 15, copying Staff Employee, to note that a "signed management representation letter" needed to be obtained "before we can grant final consent" to release the audit opinion. Ex. J-48 at 3. Stewart did not specify whether the letter was missing from the 2011 work paper file, the 2012 work paper file, or both. Staff Employee responded early the next morning that "[w]e have it in the file," and Harris clarified a few hours later that it could be found "in the Dropbox." Ex. J-48 at 1-2. Stewart then emailed Harris and Staff Employee to say that he had "[f]ound the management representation letter. Signed off on Work papers. Hitor can file." Ex. J-47 at 1. As noted above, identical copies of the same management representation letter appear in both the 2011 reaudit and 2012 audit work paper files. Stewart stipulated that the record contains "complete copies of Respondent's audit work papers for the December 31, 2011 reaudit and December 31, 2012 audit of Hitor Group, Inc." at Exhibits J-10 and J-17, respectively. R.D. 30.

To Stewart, his April 16, 2013 "sign-off" meant that he had "completed [his] work" on the audits and that it was appropriate for Hitor to proceed with filing its 2012 Form 10-K. Tr. 54-55.[8/] Stewart understood that Hitor's 2012 10-K would include an audit report in the name of the Harris Firm on Hitor's 2012 and 2011 financial statements and that the opinion would be unqualified but the audit report would include a "going concern" explanatory paragraph. Tr. 59-60, 63; *see* Br. 14. Stewart testified that he understood that even when an audit report is expected to include a going concern paragraph, "[y]ou have to do an audit in accordance [with] PCAOB standards." Tr. 68.

On April 16, 2013, Hitor filed a Form 10-K with the SEC that contained Hitor's financial statements for the years ended December 31, 2011 and December 31, 2012. Ex. J-44 at 12. The Form 10-K contained an "Independent Auditor' [sic] Report on Financial Statements" in the name of the Harris Firm and dated April 15, 2013. The audit report stated, "We have audited the accompanying financial statements of Hitor Group, Inc., which comprise the balance sheet as of February 28, 2013, and the related statements of income, stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements." *Id.* at 10-11. The audit report further stated that the audit had been conducted "in accordance with auditing standards generally accepted in the United States of America." *Id.* at 10. The numbers reported on the re-issued 2011 financial statements were identical to those reported by Hitor in the original 2011 10-K filed the prior year. *Compare* Ex. J-15 at 11 *with* Ex. J-44 at 12.

[8/] At the time of Stewart's "sign-off" email to Harris, Stewart knew that the engagement quality reviews of the 2011 reaudit and the 2012 audit had not yet been performed and that "the quality review partner would not initiate his work until the engagement partner signed off on it." Tr. 232. Stewart testified that he believed that the engagement quality review should have been completed before the audit report for both audits was released, but conceded that such review was not completed. Tr. 242.

On September 27, 2013, Hitor filed an amended Form 10-K to, among other things, "correct" "errors" in the audit report. Ex. J-51 at 4. The corrected audit report, in the name of the Harris Firm and dated April 15, 2013, stated, "We have audited the accompanying balance sheets of Hitor Group, Inc. (A Development Stage Company) as of December 31, 2012 and December 31, 2011, and the related statements of income, stockholders' equity and cash flows for the period then ended, and the period July 15, 2005 (inception) to December 31, 2012." *Id.* at 6. It further stated, "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." *Id.* Both the original and corrected audit reports opined that Hitor's financial statements "present fairly, in all material respects, the financial position of Hitor Group, Inc.," and both contained an explanatory paragraph noting that there was substantial doubt about Hitor's ability to continue as a going concern. Exs. J-44 at 10, J-51 at 6. There is nothing in the record to indicate that Stewart played any role in the issuance of the corrected audit report or in Hitor's filing of the amended Form 10-K.[9/]

IV.

The OIP charged that in the 2011 reaudit and the 2012 audit of Hitor, Stewart violated PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*, and Rule 3200T, *Interim Auditing Standards*, by:

- failing to exercise due professional care and skepticism, in violation of AU § 150, *Generally Accepted Auditing Standards*, and AU § 230, *Due Professional Care in the Performance of Work*;

- failing to obtain sufficient appropriate audit evidence for certain significant items in Hitor's 2011 and 2012 financial statements to support the opinion expressed in the audit report on those financial statements, in violation of Auditing Standard No. 15, *Audit Evidence*;

- failing to perform procedures to address insufficient appropriate audit evidence concerning relevant assertions, in violation of Auditing Standard No. 14, *Evaluating Audit Results*;

9/ Several years after the period at issue here, the SEC revoked the registration of Hitor's securities for failure by the company to file any periodic reports since September 2014. *See Bill the Butcher, Inc., Hitor Grp., Inc., Xun Energy, Inc.*, SEC Rel. No. 34-79653, 2016 WL 7406287 (Dec. 22, 2016).

- failing to adequately plan the audits, in violation of Auditing Standard No. 9, *Audit Planning*;

- failing to adequately supervise engagement personnel, in violation of Auditing Standard No. 10, *Supervision of the Audit Engagement*;

- failing to identify and assess the risks of material misstatement, in violation of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*; and

- failing, to the extent Stewart performed sufficient or adequate audit procedures that were alleged to be insufficient or inadequate, to ensure that those procedures were documented, in violation of Auditing Standard No. 3, *Audit Documentation*.

V.

The Division of Enforcement and Investigations bears the burden of proving by a preponderance of the evidence that Stewart engaged in an act or practice, or omitted to act, in violation of PCAOB rules and auditing standards, as charged in this case. PCAOB Rule 5204; *see* Sarbanes-Oxley Act Section 105(c)(4), 15 U.S.C. § 7215(c)(4); PCAOB Rule 5300(a). Our findings are based on a *de novo* review of the record. PCAOB Rules 5460(c), 5465. We apply the rules and standards as they existed at the time of the alleged violations, based on "what the accountant knew or should have known at the time an action was taken or a decision was made." *See, e.g., Kevin Hall, CPA*, SEC Rel. No. 34-61162, 2009 WL 4809215, *7 (Dec. 14, 2009).

PCAOB rules require that associated persons of registered public accounting firms comply with applicable auditing and related professional practice standards in connection with the audits of issuers. PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, Interim Auditing Standards. Stewart was aware of his obligation to perform the 2011 reaudit and 2012 audit in accordance with PCAOB standards. Tr. 68-69. Those standards require that an auditor exercise due professional care and maintain an "independence in mental attitude," including a "questioning mind and a critical assessment of [the] audit evidence" throughout the audit. AU §§ 150.02, 230.01, .07.

PCAOB standards also require the engagement partner to "supervise the audit engagement, including supervising the work of engagement team members so that the work is performed as directed and supports the conclusions reached." AS No. 10. Supervising an audit engagement requires the engagement partner to: (a) inform engagement team members of their responsibilities, including the objectives of the procedures to be performed, the nature, timing, and extent of procedures to be performed, and matters that could affect the procedures to be performed or the evaluation of the results of those procedures; (b) direct engagement team members to bring significant accounting and auditing issues to the engagement partner's attention; and (c) review the work of the engagement team to evaluate whether the work was performed and documented, the objectives of the procedures were achieved, and the results of the work support the conclusions reached. *Id.* at ¶ 5.

Under PCAOB standards, the engagement partner may "seek assistance from appropriate engagement team members" in planning the audit, but he or she remains "responsible for the engagement and its performance" and is, accordingly, "responsible for planning the audit." AS No. 9 ¶ 3. In audit planning, an auditor should "establish an overall audit strategy that sets the scope, timing, and direction of the audit" and develop and document an audit plan that describes, among other things, "[t]he planned nature, timing, and extent of tests of controls and substantive procedures." *Id.* at ¶¶ 8-10.

In connection with the planning and performance of an audit, the auditor should also identify and assess the risks of material misstatement in the financial statements. AS No. 12. These procedures should be "sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud, and designing further audit procedures." *Id.* at ¶ 4. Required risk assessment procedures include conducting a discussion among "all engagement team members who have significant engagement responsibilities, including the engagement partner," concerning the risks of material misstatement and inquiring with management about the risks of material misstatement that exist. *Id.* at ¶¶ 49-55.

PCAOB standards require that the auditor plan and perform procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. AS No. 15 ¶ 3. Such evidence is "appropriate" if it is both "relevant and reliable in providing support for the conclusions on which the auditor's opinion is based." AS No. 15 ¶ 6. Reliability, in turn, "depends on the nature and source of the evidence and the circumstances under which it is obtained," and in general, the reliability of audit evidence is greater when "obtained from a knowledgeable source that is independent of the company" and or, if obtained from the company itself, "when the company's controls over that information are effective." AS No. 15 ¶ 8. PCAOB standards require that, if an auditor has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor should perform procedures to obtain further audit evidence to address the matter. AS No. 14 ¶ 35. If the auditor is unable to obtain sufficient appropriate audit evidence to have a reasonable basis to conclude about whether the financial statements as a whole are free of material misstatement, the auditor should express a qualified opinion or a disclaimer of opinion. *Id.*

The standards also require the auditor to document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions. Such documentation must demonstrate that the audit work was in fact performed and contain sufficient information to enable an experienced auditor to understand the nature, timing, extent, and results of procedures performed (and who performed them), the evidence obtained, and the conclusions reached. AS No. 3 ¶ 6.

Referring collectively to his work on both the 2011 reaudit and 2012 audit, Stewart has stated that "this was not a perfect audit" and "there's a number of things that could be done better on this" but that he "certainly would not intentionally violate a PCAOB rule." Tr. 234, 236. He testified that he believed he exercised due professional care, exercised appropriate levels of professional skepticism, and performed audits that produced sufficient evidence to support the audit report. Tr. 234-35. In support of his petition for review, Stewart not only argues that "[h]is work was sufficient for planning and supervising the Reaudit and the Audit" because "the lack of complexity and the small size of the Client meant that less was required," which was the focus of his briefing to the hearing officer, but also lists various steps he claims to have taken in planning and supervising those audits. R.D. 41, Opening Brief (Br.) 3-7. He raises numerous objections to the initial decision's findings regarding discrepancies and inconsistencies in the work papers and asserts that "sufficient audit evidence" was secured "as required by the pertinent" auditing standards. Br. 9-13, 20-22. Stewart argues that "the sanctions" ordered by the initial decision are "excessive and oppressive and not otherwise appropriate to the findings or the basis on which the Sanctions were imposed," focusing particularly on the civil money penalty, which he characterizes as "a purely punitive action" because he does not intend to participate in any more issuer audits and should not be "penalized" for having requested a hearing instead of settling the proceeding against him. Br. 23; R.D. 44, Reply Brief (Reply) 4-5.

The Division contends that Stewart "consistently fails to…take any responsibility for his own work—or his demonstrated lack of work—as the engagement partner for the Audits" and "fails to identify any evidence, or any legal argument, that would undermine the Hearing Officer's findings and conclusions." R.D. 42, Opposition Brief (Opp.) 1-2. Instead, the Division argues, Stewart has submitted a "laundry list of actions he purportedly took as the engagement partner" in satisfaction of his obligations to plan and supervise the audit that were merely "logistical, not substantive," "inadequate to fulfill his obligations under PCAOB auditing standards," or "not supported by the evidentiary record." Opp. 5-6. The Division contends that Stewart's "arguments as to why the audit evidence obtained was sufficient to support unqualified opinions on Hitor's 2011 and 2012 financial statements" are "irrelevant and unsupported." Opp. 9. The Division urges us to affirm the sanctions ordered by the hearing officer as supported by the record and by relevant precedent. Opp. 20-24.

We find that the Division proved by a preponderance of the evidence that Stewart fell far short of fulfilling his fundamental responsibilities to exercise due care, to plan and supervise the audits, and to obtain sufficient appropriate evidence to support the audit opinion. As discussed in detail below, Stewart violated multiple PCAOB auditing standards. His arguments to the contrary are unsupported by the record, applicable auditing standards, or applicable law.

A. Stewart failed to adequately plan, assess risks for, and supervise both audits.

The record overwhelmingly establishes that Stewart by design played an all but non-existent role as engagement partner on the Hitor audits. By his own account, Stewart understood that Harris expected him to have almost no involvement in planning the audits in question or supervising Staff Employee's work, as Harris believed Staff Employee was nearly ready to become a partner at the Harris Firm. Stewart may have fulfilled Harris's expectations, but in doing so he fell far short of fulfilling his obligations as an engagement partner under PCAOB auditing standards. *See, e.g.,* AS No. 10 ¶ 3 (stating that the "engagement partner is responsible for the engagement and its performance" and therefore "is responsible…for compliance with PCAOB standards"); App. A of AS No. 10; *Robert D. Potts, CPA*, SEC Rel. No. 34-39126, 1997 SEC LEXIS 2005, *2 (Sept. 24, 1997) (engagement partner has "primary responsibility for assuring the accuracy of these audits"), *aff'd*, 151 F.3d 810 (8th Cir. 1998).

Under AS No. 9, the engagement partner is specifically responsible for planning the audit. Yet Stewart played no role at all in establishing an audit strategy or plan for either the 2011 reaudit or the 2012 audit. He says he held "no formal planning session" with Staff Employee, but there is no evidence Stewart had any meaningful involvement in any planning—formal or informal. Tr. 49. Although AS No. 9 permits the partner to "seek assistance" from appropriate audit team members in planning the audit, Stewart did more than "seek assistance" from Staff Employee: he left the planning function entirely to Staff Employee, despite the fact that Stewart had no prior experience working with him. Stewart knew that Staff Employee was going to use generic audit programs for the audits at issue, but Stewart provided no instructions or guidance regarding their use, instead allowing Staff Employee himself to determine "which procedures in those pre-printed forms were applicable and which ones weren't applicable." Tr. 40.

The efforts Stewart makes in his brief to characterize himself as taking an active role in planning the Hitor audits are wholly unsupported by the record and contrary to his own unequivocal testimony. *See, e.g.*, Tr. 40, 49, 75, 90, 179-80, 184, 188-90. Stewart now asserts that he "arranged a conference call for April 10, 2013 with Mr. Harris to discuss his work for the Harris Firm." Br. 4. But the only support he offers for this claim is an email sent from Harris to Stewart informing Stewart that "the two audits that we need you to sign off as partner in charge" were nearly complete—well beyond the planning stage—to which Stewart merely responded, "I will be able to review the files this week. I will call tomorrow." Ex. J-33. Stewart also claims that he "consulted with the Harris Firm prior to his engagement…to determine if there were any changes in the Client's operations that might necessitate a change in the previously used audit program for this Client" and that Stewart "approved using an audit program consistent with that used in prior years." Br. 3-4. But the only support Stewart cites for these assertions is his own testimony that he was simply "aware" that Harris and Staff Employee "were going to use generic [audit] programs and that's a common procedure." Tr. 38, 48. There is no evidence in the record that Stewart analyzed the client's "operations" or its impact on the audit, provided any input on any aspect of the audit plan, or took any action to "approve" the audit plan, except for his after-the-fact sign-off on Staff Employee's completed work papers. Stewart's total abdication of his audit planning responsibilities violated AS No. 9.

Stewart also failed in the 2011 reaudit and the 2012 audit to identify and assess the risks of material misstatement in Hitor's financial statements, in violation of AS No. 12. He testified that he did not discuss with Staff Employee the risks of material misstatement presented by the audits. Tr. 75, 184. Nonetheless, Stewart claims that he appropriately sought "assistance in fulfilling his responsibilities from engagement team members" and that "appropriate Client inquiries were made." Br. 19. But the only evidence of any such "Client inquiries" is the "Fraud Awareness Questionnaire" and the "Analysis of Internal Controls for the year ended December 31, 2012" forms that Staff Employee collected from Hitor management, ostensibly designed to help "identify types of potential weaknesses in internal control and factors that affect the risk of fraud, and…consider the effect on the planning of [the] audit" (Ex. J-10 at 243, 245). Stewart knew that Staff Employee did nothing with the collected information but place a copy of the two completed forms in each work paper file, and Stewart himself did nothing with the information. Ex. J-10 at 243-45; Tr. 91-92. It is unclear from either document whether management intended its responses to apply to one or both audits or whether the information provided was actually relevant to circumstances as they existed in only 2012, or 2011 and 2012, and there is no evidence that Stewart or Staff Employee even considered the question at the time or applied the information to any assessment of risk.

Although these two forms are the only evidence that the engagement team made any client inquiries to assess the risks of material misstatement, Stewart attempts to minimize their importance by suggesting that "the Client's size…eliminat[ed] the need to conduct much of an assessment of internal controls." Br. 6-7. But in doing so he ignores the fact that, on their face, the forms were designed to elicit information bearing broadly on fraud risk factors, not just potential weaknesses in internal controls.[10/]

And more significantly, there is no evidence that Stewart ever considered or discussed with Staff Employee how the company's lack of internal controls might impact the conduct of the audits, or that Stewart was even aware that, despite the lack of internal controls, the work papers for the 2011 reaudit and the 2012 audit reflected an assessment that control risk—the risk that a material misstatement will not be prevented or detected on a timely basis by the company's internal controls—was low. *See* Ex. J-10 at 246, 248; Ex. J-17 at 222-23; Tr. 93; AS No. 8 ¶ 7.b ("Control risk is a function of the effectiveness of the design and operation of internal control."). Stewart's abdication of his responsibilities to assess the risks of material misstatement violated AS No. 12.

Stewart also violated AS No. 10 by failing to supervise Staff Employee in any meaningful way. Stewart's "supervision" of Staff Employee during planning and performance of the audit was limited to being copied on emails between Staff Employee and Hitor management, to which Stewart made no response. After Staff Employee's audit work was completed, Stewart's involvement was limited to spending about four hours reviewing the work papers prepared by Staff Employee before signing off on the issuance of an unqualified audit opinion for both of the audits.

Despite admitting repeatedly at the hearing that he understood from the inception of his role as engagement partner that the plan "was to have [Staff Employee] do as much as possible in his audit without direct supervision from me" (Tr. 49; *see* Tr. 39-40 (describing his review as "very minimal"), 180-81, 72-73, 217-18), Stewart now claims to have performed a list of tasks that demonstrates his active involvement in planning of the audits and supervision of assistants in accordance with PCAOB standards (Br. 4-5).

[10/] As explained in note 6 above, certain responses on the Analysis of Internal Controls form relating to whether Hitor had any employees conflicted with statements in the company's Form 10-K, and the Form 10-K itself was internally inconsistent on this point. *Compare* Ex. J-10 at 245 and J-17 at 221 with Ex. J-10 at 329 and Ex. J-44 at 4-5. Stewart, in arguing that the information reported by management on Form 10-K "is a subsequently arising fact unknown to [him] at the time [of the audits]" (Br. 18), ignores that the draft Form 10-K containing the inconsistencies is, in fact, part of the work papers he claims to have reviewed. Ex. J-10 at 329; R.D. 30; Br. 5. Given the abundant evidence that Stewart and Staff Employee did practically nothing to assess the risks of material misstatement, we note Stewart's failure to notice the inconsistencies between the so-called Analysis of Internal Controls and the Form 10-K merely to highlight that overall lack of audit work and that, as discussed below, Stewart failed to exercise due care in his review of the work papers Staff Employee prepared.

But the substantive steps he claims to have taken either did not occur according to the record evidence or were inadequate to fulfill his obligations under PCAOB standards.

First, the list of tasks Stewart cites confirms, rather than refutes, his failure to fulfill his obligations under PCAOB standards. For example, Stewart asserts that he "assured that the Client signed an engagement letter," "coordinated with audit staff so that they knew when his review of the final work papers would be completed," "provided direction to [Staff Employee] as to the format of the audit opinion," and "notified the Harris Firm staff when his review of the final audit work papers was complete." Br. 4-5. Such tasks do not come close to addressing the substantive requirements of any of the standards discussed, including AS No. 9, AS No. 10, and AS No. 12.

Second, claims in Stewart's brief that he took certain actions are not borne out by the record. For example, according to the brief, he "approved the selection and use of an [sic] commercially available, and widely used audit program." Br. 4, 7. But the testimony cited for that proposition does not support it. That testimony merely reflects Stewart's admission that it was Staff Employee, not Stewart, who "determined which procedures in those pre-printed forms were applicable and which ones weren't applicable." Tr. 40. That testimony further confirms that Stewart gave no instruction to Staff Employee about the "nature, timing, and extent of procedures" to be performed, as he was required to do under AS No. 10 ¶ 5(a)(2).

Stewart's brief also claims he "assured appropriate audit information was solicited from" Hitor and that Hitor "provided necessary information." Br. 4. But the joint exhibits cited for this proposition consist of nothing more than emails on which Stewart was copied, and do not show any work on his part to satisfy himself that Staff Employee had the information and documentation necessary to proceed with the audit. *See* Exs. J-28 (email from Staff Employee to Hitor, copying Stewart), J-30 (same), J-31 (same).

Stewart next points to Exhibits J-32 and J-34 to claim he "assured that the Client facilitated access by the audit team to necessary bank account statements and other information needed to complete the audit" and that "questions about the value of the Client's inventory were asked and answered by the Client." Br. 4. But those exhibits, too, are emails between other persons on which he was merely copied. *See* Ex. J-32 (email between Harris and Hitor); Ex. J-34 (email between Harris and Staff Employee).

Similarly, Stewart claims he "assured that both the Harris Firm audit team and the external quality review auditor had access to the audit file" and "assured that there was no disagreement between either the Harris Firm audit team and the quality review auditor as to necessary adjustments to the Client's financial statements or questions raised in the audits about the Client's financial statements," citing certain emails on which Stewart was copied. Br. 5 (citing Exs. J-36, J-37). Neither these emails nor contemporaneous emails in Ex. J-35 support Stewart's assertions, for the engagement quality review is not mentioned and the person Stewart identified as the engagement quality reviewer is not even copied. *See* Tr. 106-07 (identifying accountant who prepared the financial statements); Tr. 242 (identifying auditor who was to serve as the engagement quality reviewer). More than that, these emails undercut Stewart's claims of responsible involvement; they document that Staff Employee was informing the accountant who prepared Hitor's financial statements that, for example, certain accounts "look[] like a mess that needs to be reconciled" and other assertions were from an "unknown source," without indicating any effort by Stewart—who made no reply to the emails—to find out if, or how, these concerns were ever addressed. Ex. J-36.

Also, the belated, unsubstantiated claim in Stewart's brief that he "assured that there was no disagreement between either the Harris Firm audit team and the quality review auditor" flies in the face of the evidence that no such review was ever conducted and that Stewart never concerned himself with finding out if any such review had been done or whether any issue raised in that review required attention. Stewart's attempt before us to depict himself as playing an active role in the audits is undermined by his lack of any inquiry, under the circumstances, into whether Harris was working on the audits. *See* pages 5-6 above. In short, there is no support in the record for Stewart's claims that he took any meaningful action to fulfill his role as engagement partner in planning or supervising the audits under AS Nos. 9, 10, and 12.

Finally, Stewart argues he is not liable for any failure to supervise Staff Employee because he "met the requirements applicable to him" under Sarbanes-Oxley Act Section 105(c)(6), 15 U.S.C. 7215(c)(6). Br. 15. This defense fails for multiple reasons.

First, Stewart misconceives that provision. Section 105(c)(6)(B) provides for an affirmative defense in certain circumstances to a proceeding brought under Section 105(c)(6)(A). Section 105(c)(6)(B) applies only when the Board proceeds under Section 105(c)(6)(A), which the Board is not required to do to sanction an engagement partner under Section 105(c)(4) for violating auditing standards that govern supervision by engagement partners. Here, the Board did not proceed under Section 105(c)(6)(A).

Specifically, PCAOB auditing standards contain requirements related to the supervision of engagement team members that address staffing the audit, supervision of audit work by the lead partner and others on the engagement team, and review of the work of assistants on the team. *See* AU § 230.06, AS No. 10. Section 105(c)(4), under which this proceeding was brought, authorizes the Board to sanction firms and their associated persons for violations of those supervision standards. The Board did so, for example, in *Deloitte & Touche LLP*. PCAOB Rel. No. 105-2007-005 (Dec. 10, 2007) at 5 & n.4 (settled order censuring firm and imposing civil money penalty for, among other things, failure to staff an engagement in accordance with AU § 230.06). Section

105(c)(6) extends that authority, providing a basis for imposing sanctions on individuals beyond the engagement team for failures reasonably to execute supervisory responsibilities related to a person who commits a violation of auditing standards.

Section 105(c)(6)(A) provides a distinct enforcement tool for the Board to use in circumstances where an individual who has not been reasonably supervised has violated certain laws, rules, or professional standards. In such circumstances, Section 105(c)(6)(A) affords the Board broad authority to impose sanctions on a firm or an individual for failing reasonably to supervise, without regard to whether any rules or standards specifically governing supervision were violated,[11/] and without limiting the sanctionable supervisory individuals only to those on an audit engagement team.

Second, even if Section 105(c)(6)(B) were relevant, Stewart has failed to establish the elements of the affirmative defense that subsection sets out. Specifically, subsection B states that no supervisory person can be found to have failed reasonably to supervise under subsection A if all of these conditions are met: (1) the individual reasonably discharged the supervisory duties placed on him or her by the firm's procedures; (2) he or she had no reasonable cause to believe the firm's procedures were not being complied with; and (3) the firm's procedures comply with applicable PCAOB rules and would reasonably be expected to prevent and detect the violation. Stewart makes no attempt to establish either that the Harris Firm established procedures reasonably expected to prevent or detect violations of PCAOB standards or that he reasonably discharged his duties or obligations incumbent under any such procedures. Nor could he do so on this record.

11/ Section 105(c)(6) addresses supervision in terms that are "similar to those that apply to broker-dealers under section 15(b)(4) of the Securities Exchange Act of 1934." S. Rep. No. 107-205 at 11, 49. Securities Exchange Act Section 15(b)(4)(E), 15 U.S.C. 78*o*(b)(4), and its companion provision, Section 15(b)(6), 15 U.S.C. 78o(b)(6), "create liability" for broker-dealers and their associated persons when "inadequate supervision is coupled with a violation by [a] supervisee," while sanctions for direct violations of the securities laws are authorized by other portions of the statute. *See, e.g., Collins v. SEC*, 736 F.3d 521, 524, 527 (D.C. Cir. 2013) (affirming sanctions against supervisor of registered representative and describing respondent as "within the class of persons for whom the statute was designed—an individual supervising persons subject to securities laws"); *Thomas C. Bridge*, SEC Rel. No. 34-60736, 2009 WL 3100582 (Sept. 29, 2009) (imposing sanction under Exchange Act Section 15(b) on registered representative for violations of the antifraud provisions of the securities laws and imposing sanctions under Securities Exchange Act Sections 15(b)(4)(E) and 15(b)(6) on representative's supervisor for failing to reasonably supervise him).

Third, Stewart did not raise his Section 105(c)(6) argument until his brief on review to us. *See* Br. 15 (raising argument for first time); R.D. 13 (Stewart's answer, asserting no affirmative defense and making no reference to Section 105(c)(6)). Having failed to raise any such defense in a timely manner, Stewart waived it. *See* PCAOB Rule 5421(c) ("any" matter "constituting an affirmative defense shall be asserted in the answer"); *Mark E. Laccetti, CPA*, PCAOB File No. 105-2009-007, at 83-84 (Jan. 26, 2015) (holding that respondent waived affirmative defense by not timely raising it), *aff'd*, SEC Rel. No. 34-78764, 2016 WL 4582401 (Sept. 2, 2016), *appeal filed on other grounds*, *Laccetti v. SEC*, No. 16-1368 (D.C. Cir. Oct. 31, 2016); *see also, e.g., Laurie Jones Canady*, SEC Rel. No. 34-41250, 1999 WL 183600, *12 (Apr. 5, 1999). For all of these reasons, we reject Stewart's attempt to evade liability for his violations of PCAOB auditing standards by resort to an inapplicable legal defense.

B. Stewart failed to obtain sufficient appropriate evidential matter to support material assertions in Hitor's financial statements and to exercise due professional care and skepticism.

Stewart's only discernible contribution to the reaudit and audit of Hitor's financial statements was to receive certain emails and review the work papers prepared by Staff Employee. Yet this contribution in itself failed to meet PCAOB standards, as Stewart's cursory review of Staff Employee's work fell far short of an exercise of due professional care or of a "critical assessment of [the] audit evidence." AU §§ 150.02, 230.01, .07. In receiving the emails and reviewing the work papers for both the 2011 reaudit and the 2012 audit, Stewart missed or ignored a series of glaring signs that audit conclusions regarding material assertions in Hitor's financial statements were not supported by audit evidence sufficient to provide a reasonable basis for the audit opinion. Despite never having worked with Staff Employee before these audits and knowing nothing about Staff Employee's qualifications as an auditor except that he was a CPA whom Harris hoped to promote to partner, Stewart signed off on every aspect of the audits without asking a single question about the obvious deficiencies and discrepancies in the work papers.

Specifically, in reviewing the 2011 reaudit work papers, Stewart failed to notice, or ignored, serious deficiencies in the documented work done to support the amounts Hitor reported as assets (cash and inventory) and as liabilities (convertible notes payable, deposit, and notes payable). Cash represented more than 59% of Hitor's reported current assets, yet Stewart failed to notice or question the fact that Staff Employee deviated from the audit plan and relied on unverified, client-prepared documents to test cash balances, without performing any procedures to test the balances as of the actual (year-end) date reported on the financial statements. Inventory represented over 40% of the company's total reported assets, and although Staff Employee requested documentation from management to support the valuation of the inventory for 2011, Stewart never asked whether such documentation was received, and never questioned the absence of any such support in the work papers, despite knowing the value of the inventory would be reduced to zero in the 2012 financial statements. Convertible notes payable of $400,000, a deposit of $150,000, and notes payable of $81,270 represented 78% of Hitor's total reported liabilities. Despite being copied on an email in which Staff Employee told management that two of the three accounts were "old and I have no idea what for," Stewart signed off without comment or question on work papers that did not document any procedures done to test whether these items were fairly stated. And Stewart's sign-off notwithstanding, the work papers for the 2011 reaudit contained no lawyer response letter at all and a management representation letter that pertains only to Hitor's financial statements for 2012, not 2011.

In reviewing the 2012 audit work papers, Stewart failed to notice, or ignored, obvious deficiencies in the documented work done to support the amounts Hitor asserted as assets (inventory, prepaid expenses, and an investment in Hitor Poland) and as liabilities (convertible notes payable and notes payable). Hitor reduced its reported assets by 38% when it wrote off its inventory in 2012. Yet Stewart, who was aware that Staff Employee had not yet ascertained management's "stance" on the inventory write-off as late as April 3, failed to question the lack of any documentation in the work papers supporting the existence or valuation of the inventory or considering the question whether the write-off was appropriately taken in 2012 instead of in the prior year. Nor did Stewart question whether the write-off had any impact on the relevant assertions of notes payable, one of which was "secured" by this now valueless inventory. Prepaid expenses represented 47% of Hitor's reported current assets, yet the only work Staff Employee documented to test this assertion was to locate a related contract that was unsigned and bore no indication of how the agreement for services supported the $57,617 Hitor reported for prepaid expenses on its balance sheet. Even though Hitor reported an "Investment in Hitor Poland LLC" that represented 16% of its total reported assets, Stewart failed to notice or question that the invoice supposedly supporting this assertion did not support the entire amount or reference Poland at all. Finally, Hitor's reported convertible notes payable and notes payable represented 65% of its current liabilities, yet Stewart failed to notice or question the lack of documentation in the work papers of any procedures done to test the reported figures.

The work papers patently demonstrate that insufficient work was done to gather evidence to support a series of relevant assertions of significant accounts in the financial statements. Stewart's failure to notice this, or, if he did notice it, his failure to question it in any way, violated PCAOB standards requiring that he obtain sufficient appropriate audit evidence to support the audit opinion, perform procedures to address insufficient appropriate audit evidence concerning relevant assertions of significant accounts, and exercise due professional care, including professional skepticism. AS Nos. 14, 15; AU §§ 150, 230. None of the defenses Stewart offers is meritorious.

First, Stewart asserts generally that Staff Employee obtained sufficient audit evidence with respect to "inventory, bank balances, investment in Hitor Poland and cash balances, notes payable, deposits, and liabilities with respect to the Reaudit and the write-off of inventory on the balance sheet for December 31, 2012" and Stewart "appropriately relied on [Staff Employee's] work." Br. 21. As his only support for this broad statement, Stewart cites Exhibit J-6 (with no reference to any specific page), which is a set of work papers prepared in the original 2011 audit, and claims he "appropriately relied on the 2011 audit records in conducting the Reaudit." Br. 21. We reject Stewart's claim of reliance on audit documentation from the original 2011 audit. His argument represents nothing more than an "after-the-fact rationalization" that is not supported by contemporaneous evidence. *See, e.g., Wendy McNeeley, CPA*, SEC Rel. No. 34-68431, 2012 WL 6457291, *11 (Dec. 13, 2012).

Stewart specifically and unequivocally testified that he did not review Exhibit J-6 at the time he conducted the 2011 reaudit and the 2012 audit. Tr. 117. There is no evidence that he reviewed at that time the other exhibit from the work paper file of the original 2011 audit, Exhibit J-11. *Id.* Nor is there evidence that he evaluated the work on the original 2011 audit.[12/]

[12/] Stewart, rather than identifying any contemporaneous evidence that he actually relied on work papers from the original 2011 audit, instead cites AU § 315, *Communications Between Predecessor and Successor Auditors,* and asserts that he was "rightfully entitled to rely on information obtained in the original 2011 audit to inform the Reaudit and the Audit both as to audit procedures and planning." Br. 14. But he concedes that he "was not technically a successor auditor as defined by AU Section 315" and, at best, contends that AU § 315 could apply here only as "illustrative of good audit policy." Br. 14. While we take no position on that contention, we note that the standard would not help Stewart in any event. He ignores that AU § 315 provides that "the information obtained from [] inquiries [of the predecessor auditor] and any review of the predecessor auditor's report and working papers is not sufficient to afford a basis for expressing an opinion. The nature, timing, and extent of the audit work performed and the conclusions reached in the reaudit are solely the responsibility of the successor auditor performing the reaudit." AU § 315.15. And to the extent Stewart is attempting to validate, by reference to AU § 315, his assertion that he had no choice but to rely on the 2011 inventory count done by Harris because "you can't go back in time and do that inventory count for the 2011 [reaudit]" (Tr. 120-21), that argument again fails on its own terms. Although AU § 315.20 recognizes that the successor auditor "generally will be unable to observe inventory or make physical counts at the reaudit date," it provides that the auditor instead "should, if material, observe or perform some physical counts of inventory at a date subsequent to the period of the reaudit, in connection with a current audit or otherwise, and apply appropriate tests of intervening transactions." There is no evidence any such work related to Hitor's inventory was done in the Stewart-led audits.

Stewart also implies that overall his audit work was rigorous and complete because he not only reviewed the work papers for the 2011 reaudit and 2012 audit but also "the general ledger," maintained by Hitor as QuickBooks files that Stewart now contends should have been, but were not, made available at the hearing. Br. 9, 11, 13, 21. Stewart's argument ignores the fact that he unequivocally represented that Exhibits J-10 and J-17 are his complete sets of work papers for the audits. If Stewart believed that Hitor's general ledger—the client's accounting records—contained his audit work, he could have presented those files as exhibits at the hearing, but he failed to do so.[13/]

In any event, reading a general ledger, no matter how carefully or intently—without adequately testing any of the accounts, transactions, or journal entries—cannot provide sufficient appropriate audit evidence. *See, e.g.,* AS No. 13 ¶¶ 8, 36–37 (the auditor is required to perform substantive procedures to test the relevant assertions of the significant accounts in order to address the risk of material misstatement); AS No. 15 ¶ 10 (when using information produced by the company as audit evidence, the auditor is required to "[t]est the accuracy and completeness of the information" where there are no internal controls over its accuracy and completeness and must "[e]valuate whether the information is sufficiently precise and detailed for purposes of the audit"). There is no evidence that Stewart performed any such testing, nor has he attempted to describe what that testing entailed. If he had performed such work, it should have been, but was not, documented in the work papers. *See, e.g., McNeeley,* 2012 WL 6457291, *11, *13 ("'[T]he absence of work papers [is] evidence that the audit team did not devote substantial, if any, effort to review the areas in question.'"); *Gregory M. Dearlove*, SEC Rel. No. 34-57244, 2008 SEC LEXIS 223, *32 n.39 (Jan. 31, 2008) (stating that work papers "are ordinarily the foundation on which support for audit conclusions is demonstrated" and that "[w]e consider the absence of work papers to be evidence that

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13/ Stewart's brief implies that he sought to introduce, or consult, some additional client files at the hearing that could have assisted in his defense but was prevented from doing so, claiming that, "[d]uring the hearing, through no fault of Mr. Stewart, neither the investigators nor the Hearing Officer could open the QuickBooks electronic file provided by Mr. Stewart; they relied on hard copies of only those specific documents that the investigators asked Mr. Stewart to provide to them." Br. 9 (citing Tr. 172:3-21); *see* Br. 11, 12, 13 (all citing to Tr. 172:3-21). There is no support for this *post hoc* argument. As Stewart explained in the cited testimony, during the investigation he provided the Division with an electronic copy of his work papers that turned out to be unreadable, and so he provided the Division with a second copy that was readable. Stewart has never suggested that this second file was somehow incomplete or corrupted. All exhibits in this case were introduced as joint exhibits. Stewart brought no other materials to the hearing nor sought to introduce any other materials. He stipulated without reservation or exception that two joint exhibits (Exhibits J-10 and J-17) constituted complete copies of his work papers.

the audit team did not devote substantial, if any, effort to review the areas in question"), *aff'd*, 573 F.3d 801 (D.C. Cir. 2009). Stewart's unsupported allusion to a "general ledger review" does nothing to mitigate his failure to devote sufficient due care to his review of the audit work papers.

In addition to these broad arguments, Stewart also offers several arguments targeted more specifically at his evaluation of certain assertions in the financial statements. These we reject as well, for the reasons set out below.

1. 2011 cash

Stewart argues that he was not required to confirm cash balances in the reaudit and that Staff Employee instead appropriately applied "supplemental methods that were allowable and acted in accordance with the standards set out in AU-C 700." Br. 9, 10, 20-21. Stewart's argument is ill-supported, for it relies on AICPA standards that do not apply in PCAOB audits such as those at issue here. It is also misplaced, for we do not find that he violated PCAOB auditing standards for failing to perform any specific procedure in reviewing Hitor's cash balances, but rather for failing to obtain sufficient appropriate evidence—by any valid procedure—to support the cash balance reported on Hitor's financial statements. The work papers indicated, via Staff Employee's initials, that Staff Employee "[r]equest[ed] confirmation as of the audit date for the bank account(s) selected" and "[d]ocument[ed] the items selected for confirmation and retain[ed] returned confirmations." Ex. J-10 at 104. In fact, Staff Employee did not do this, as is apparent from the work papers. Instead, he used bank statements he received from the client (not directly from the bank) to trace the "book balance" to "bank statement" at "various intervals throughout the year." Ex. J-10 at 107. But, as noted, Staff Employee did not perform any procedures (whether through confirmations, tracing the balance to bank statements, or other procedure) to test the cash balances as of year-end, which were the balances actually reported on the financial statements.

Moreover, although Stewart tries to frame the issue in terms of having no responsibility to "authenticate" the client's bank statements (Br. 21), PCAOB auditing standards require that auditors obtain sufficient appropriate audit evidence to provide a reasonable basis for their opinion. AS No. 15 ¶ 4. The appropriateness of that evidence is measured by its relevance and its reliability. *Id.* at ¶ 6. Its reliability, in turn, "depends on the nature and source of the evidence and the circumstances under which it was obtained." *Id.* at ¶ 8. Here, the bank statements were obtained from the company, not from an independent source, and, in general, "[e]vidence obtained directly by the auditor is more reliable than evidence obtained indirectly." *Id.* Stewart understood through email correspondence from Harris to Hitor that Staff Employee was having trouble gaining access to the statements, and the work papers plainly showed that Staff Employee had at least planned to acquire confirmations but did not ultimately do so for unknown reasons. Under these circumstances, Stewart's failure to display any semblance of "a questioning mind and a critical assessment of audit evidence" (AU § 230.07) or to perform any procedures at all to evaluate whether the bank statements were sufficient and appropriate as evidence for purposes of the audits violated AU § 150, AU § 230, AS No. 14, and AS No. 15.

2. 2011 inventory

Stewart contends that "[t]he documentary evidence at the hearing established that there was an inventory observation with respect to the 2011 audit," which "was relied on in the Reaudit." Br. 12 (citing Ex. J-11 at 55, Tr. 120-24). Stewart's claim that an inventory observation from the original 2011 audit was considered in the 2011 reaudit not only lacks support in the work papers and is contrary to the admission in his answer that he "failed to perform any procedures, and failed to ensure that [Staff Employee] performed any procedures, regarding the existence or valuation of [Hitor's] inventory [as of December 31, 2011]" (Ans. 3 ¶ 15; OIP 5 ¶ 15), but also, at best, his claim amounts to unquestioning acceptance of Harris's count and valuation of inventory, without performing any work to substantiate, confirm, or test those conclusions in the reaudit (*see, e.g.*, Tr. 123-25). The mere existence of an inventory observation in the work papers of the original 2011 audit led by Harris does not explain or excuse the lack of meaningful audit work on inventory in the Hitor audits led by Stewart. Management's ultimate determination to write off the inventory on the 2012 financial statements should have raised some question about the support for the value asserted on the 2011 financial statements, which Stewart never addressed. For all of these reasons, Stewart failed to obtain sufficient appropriate evidential matter to support Hitor's financial statement assertions related to inventory and failed to exercise due professional care, including professional skepticism.

3. 2011 management representation letter

The 2011 reaudit work papers contain only a copy of a management representation letter that applies to the 2012 audit (and was also included in the 2012 work papers). In his defense, Stewart makes two contradictory arguments. First, he argues, without elaboration or explanation, that he was "not required by AU Section 333 or AU Section 337 to secure a management representation letter for the Reaudit separate from the management letter with respect to the [2012] Audit." Br. 20. Second, he argues that he "was not required to maintain the Client's Management representation letter, as record retention was the responsibility of the Harris Firm." Br. 18-19. The plain language of AU § 333.05 contradicts Stewart's claim that no letter was necessary for 2011 if one was secured for 2012, for it provides that "[w]ritten representations from management should be obtained for all financial statements and periods covered by the auditor's report." To the extent Stewart is suggesting that he had in fact secured a letter for 2011 that complied with PCAOB standards and was included in the work papers but cannot be held accountable for its loss, that argument is inconsistent with his specific and unreserved admission that the record contains his complete work papers. R.D. 30. We decline to credit either facet of Stewart's internally inconsistent defense.

4. 2012 inventory

Stewart failed to consider the appropriateness of management's decision to write down to zero the inventory in 2012 (versus 2011). His brief offers in defense that "[t]he decision that the inventory be written-off in 2012 and not 2011 was an appropriate exercise of discretion based on changed facts between 2011 and 2012." Br. 12. He claims that "in light of the continuing absence of sales in 2012 and a change in the Client's business focus (J-17 at 309-332), the audit team reported to the Client the inventory was impaired by the end of 2012." Br. 11. But there is no support in the record for Stewart's claim; the 2012 work papers do not document a change in Hitor's business focus (nor does Stewart explain what that is), and the engagement team played no role in reporting any impairment to management.

5. 2012 notes payable

Stewart claims he "had no responsibility to answer the legal question of whether the write-off of inventory in 2012 had an impact on the note payable secured by the inventory. … The audit opinion emphasized the auditor's doubts as to the Client's ability to pay by including comments questioning whether the entity was a going concern." Br. 22; *see* Br. 23; *see also* I.D. 28-29. Stewart misstates his audit responsibilities. He was responsible for assessing whether the write-off of the inventory value had any impact on the relevant assertions of notes payable, one of which was "secured by inventory." The inclusion of a going concern paragraph in no way diminishes the auditor's duties to perform an audit under PCAOB standards. *See* AU §§ 508.07, .10, .11.

6. 2012 "investment" in Hitor Poland

As noted, Stewart failed to notice or question that the invoice supposedly supporting Hitor's asserted investment in Hitor Poland LLC did not support the entire amount or even reference Poland or Hitor Poland LLC. He tries to re-cast this simple issue by claiming that "the issue in the hearing with respect to the advance of funds to Hitor Poland LLC was not validation that an advance of funds occurred but whether the expenditure in question should have been expensed rather than capitalized." Br. 21-22. But Stewart's characterization of the issue is not supported by the transcript, was not what was charged, was not discussed or alluded to at the hearing or in briefing, and is not a basis for any finding of violation. Stewart's argument is thus irrelevant.

* * *

Based on the foregoing, the Board finds that the Division proved by a preponderance of the evidence that Stewart violated PCAOB Rules 3100 and 3200T by failing to comply with AU § 150, AU § 230, and AS Nos. 9, 10, 12, 14, and 15, in the 2011 reaudit and 2012 audit of Hitor's 2011 and 2012 financial statements.

VI.

Sarbanes-Oxley Act Section 105(c)(4) authorizes the Board to impose "such disciplinary or remedial sanctions as it determines appropriate," subject to certain limitations, on registered public accounting firms or associated persons of such firms if the Board "finds, based on all of the facts and circumstances," that the firm or person has violated PCAOB rules and auditing standards. 15 U.S.C. 7215(c)(4). With respect to a proceeding against an associated person, such as here, Section 105(c)(5) specifies that a suspension, bar, or limitation on the activities or functions of such person, as well as a civil money penalty within a certain range (in excess of $120,000 and not more than $900,000 for the pertinent period) "for each violation," "shall only apply" to "intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard" or to "repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard." 15 U.S.C. 7215(c)(5); 17 C.F.R. 201.1003, Table I. In this context, recklessness "represents an 'extreme departure from the standards of ordinary care, … which presents a danger' to investors or the markets 'that is either known to the (actor) or is so obvious that the actor must have been aware of it.'" *S.W. Hatfield, CPA,* SEC Rel. No. 34-69930, 2013 SEC LEXIS 1954, *77 (July 3, 2013). Applicable PCAOB auditing standards provide the standard of care for assessing the auditor's conduct. *Id*.

A. Stewart recklessly, if not intentionally, violated PCAOB auditing standards.

PCAOB standards require auditors to adequately plan the audit and to properly supervise any assistants, to exercise due professional care, to maintain an attitude of professional skepticism, and to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under audit. Auditors may reasonably differ in how they might tailor a particular engagement to satisfy these fundamental requirements, but Stewart's near-total abdication of these responsibilities is by definition an extreme departure from the standard of care.

At the outset, Stewart's arrangement to replace Harris as engagement partner but to have only the most "minimal" involvement in the audits (*see, e.g.*, Tr. 39-40) effectively removed the vital role of the engagement partner from the audit process. The Commission has described the "purpose of auditor rotation" as "bringing a fresh perspective to the audit" designed to promote "auditor independence" and "critical thinking." *See Dearlove,* 2008 SEC LEXIS 223, *7, *21; *see also* S. Rep. No. 205, 107th Cong., 2d Sess. (June 26, 2002) (Senate Report accompanying Sarbanes-Oxley Act) at 21 (recognizing the "strong benefits that accrue for the issuer and its shareholders when a new accountant 'with fresh and skeptical eyes' evaluates the issuer"). Neither that purpose nor the purpose of having an engagement partner in the first place is served if the rotation results in no one at all performing the role of engagement partner. By prearrangement, Stewart did next to nothing on the two Hitor audits, ceding all responsibilities for planning and performing the audits—this despite Stewart never having worked with Staff Employee before nor having any understanding of his qualifications, other than that he was a CPA. Stewart's participation essentially amounted to a four-hour review of the work papers for the two audits beginning only the day before issuance of the audit report. Prior to his sign-off, Stewart admittedly had no contact with Hitor management, did not ask Staff Employee any questions, and performed no procedures to obtain further audit evidence, despite problems that were obvious from the work papers. Although the arrangement between Stewart and Harris profited Stewart, who obtained a fee of some $3,000 for about four hours of his time (Tr. 51-54, 239-40), and the Harris Firm, which obtained $37,500 in total audit fees for the 2011 Hitor reaudit and the 2012 Hitor audit (*see* Tr. 244; Ex. J-44 at 25-26), the deal badly disserved investors' interests.

For example, the emails between Staff Employee and Hitor management, on which Stewart was copied but took no action, cried out for Stewart to devote careful attention to the audit work. That correspondence made plain that Staff Employee was having difficulty in performing particular tasks. Staff Employee noted in an April 13 email that certain line items in the company's 2012 trial balance were "new" with an "unknown source," while others were "old and I have no idea what for," and still others were "a mess that needs to be reconciled." Ex. J-36. Stewart, however, did nothing to find out whether or how Staff Employee was able to satisfactorily resolve these issues.

The work papers themselves contained so many deficiencies and inconsistencies that Stewart knew, or was reckless in not knowing, that little or no audit work was performed or audit evidence obtained to evaluate whether Hitor's financial statements were fairly stated. For the 2011 reaudit, over 40% of Hitor's assets and almost 80% of its liabilities were subject to no audit work whatsoever, and another 59% of Hitor's assets (namely, cash) was not supported by sufficient appropriate audit evidence. For the 2012 audit, over 38% of the assets and over 65% of the liabilities had been subject to essentially no procedures at all. The audit evidence supporting another 16% of assets (namely, the investment in Hitor Poland) was also facially deficient.

Stewart's minimal, all but nonexistent role in the audits, coupled with evidence that such lack of involvement was by prearranged design, means that Stewart either deliberately intended to circumvent PCAOB auditing standards or that he had the reckless view that the standards permitted such a role. His failure to respond to the numerous red flags during the audits, involving fundamental shortcomings in the audit work on accounts representing significant portions of Hitor's balance sheet, was "an egregious refusal to see the obvious or investigate the doubtful by any measure." *Hatfield*, 2013 SEC LEXIS 1954, *80 (*quoting Barrie C. Scutillo*, SEC Rel. No. 34-48238, 2003 WL 21738818, *9 (July 28, 2003) (finding auditor's failure to obtain sufficient competent audit evidence to be reckless)). At a minimum, such conduct was reckless. *Id. at* *82, *85-*86 (auditors' "repeated and nearly complete failure[] to perform adequate audit procedures created obvious, significant, and ongoing risk to investors," constituting "reckless or knowing" failure to adhere to PCAOB standards).

Stewart objects to such findings because "there were no obvious issues of fraud" at Hitor. Br. 22. But an issuer's financial statements need not be fraught with signs of possible fraud before the auditor is subject to sanctions for failing to conduct the audit with appropriate rigor. Whether or not there are "obvious issues of fraud" (*id.*), the auditor "must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud" by "reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence" (AS No. 8 ¶ 3) (footnote omitted), thus subjecting the financial statements to "the rigors of independent and objective investigation and analysis" (*McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005)). In other words, the issue here is whether the auditors performed their audit in compliance with applicable auditing standards. *Hatfield*, 2013 SEC LEXIS 1954, *85-*86 & n.145, *87-*88 n.148; *accord Gale Moore, CPA*, PCAOB File No. 105-2012-004 at 40 n.11 (Aug. 23, 2016); *cf. Gately & Associates*, SEC Rel. No. 34-62656, 2010 SEC LEXIS 2535, *50 (Aug. 5, 2010) (rejecting attempt by respondents, who "note that their conduct did not involve fraud or deceit," to "downplay the seriousness of their conduct"). Where, as here, the audit work is so deficient on its face, the auditor could not have been unaware of the danger to investors and the markets that the client's financial statements were unreliable. *See, e.g., Hatfield*, 2013 SEC LEXIS 1954, *82 (auditor's "cavalier approach to the auditing standards" presented obvious risk of harm to investors). Stewart is not "shielded" from liability even if "the audited financial statements [may have been] fortuitously…not materially misleading.'" *Dearlove*, 2008 SEC LEXIS 223, *49 n.51 (citation omitted); *see Bollt & Shapiro*, SEC Rel. No. AS-82, 1959 WL 2695, *6 (Jan. 28, 1959) ("That registrant's balance sheet was not complex and its accuracy and completeness have not been questioned in this proceeding, does not either cure or reduce the importance of the [auditing standards violations at issue].").

We further reject Stewart's related claim that in the 2012 audit, the auditors "disputed" the "value of inventory" calculated by management and "required" it to be written off, demonstrating professional skepticism and "that appropriate action was taken by the auditors based on their investigation into issues of doubt." Br. 22. There is no evidence in the record of any "dispute" over this issue, much less that the "dispute" was resolved through any insistence by any auditor. Harris simply sent an email to management in April 2013 asking without elaboration for its "stance" on the inventory, to which no response exists in the record. Ex. J-32. Indeed, contrary to Stewart's current claim in his brief, Stewart testified that the accountant who prepared the financial statements—not the auditors—proposed to write off the inventory in 2012. Tr. 203. Stewart has offered no basis for understanding his conduct as anything less than a series of extreme departures from fundamental auditing principles that created an obvious risk to the investing public. Accordingly, we conclude that, for purposes of our sanctioning authority under Section 105(c)(5) of the Sarbanes-Oxley Act, Stewart's misconduct was reckless, if not intentional.

B. Stewart's violations call for the imposition of strong sanctions.

In determining the sanctions that are appropriate for Stewart's violations, we consider the nature, seriousness, and circumstances of the violations and any potentially aggravating or mitigating factors supported by the record, to carry out our statutory responsibility to protect investors' interests and further the public interest in the preparation of informative, accurate, and independent issuer audit reports. *See* Sarbanes-Oxley Act Section 101(a), 15 U.S.C. 7211(a); *see also* Section 101(c)(5), 15 U.S.C. 7211(c)(5) (in identifying duties of Board, referring to objective "to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof" or "otherwise to carry out this Act, in order to protect investors, or to further the public interest"). Stewart's sanctions arguments do not specifically address an associational bar, a limitation on activities, or a censure, but instead focus on a civil money penalty.[14/]

Stewart's wide-ranging abdication of his audit responsibilities in the two Hitor audits is properly met with strong sanctions. *See Scutillo*, 2003 SEC LEXIS 1777, *58 ("[r]eckless failures to comply with auditing standards…'jeopardize the achievement of

14/ *See* Br. 22-24 (in "Objections to Sanctions," only specific mention of sanctions other than civil money penalty is in paragraph trying to create a context in which a $25,000 civil penalty is supposedly excessive); Reply 2-5 ("In this case, the imposition of the bar, the restriction and the censure are more than sufficient to protect the public's interest without levying the additional monetary penalties….[These other sanctions] fully protect the users of public company audits….As was the case in *Hatfield*, the additional sanction of a steep monetary penalty is not necessary to protect investors."), 7 (stating in conclusion that Board "should decline to impose the sanctions as recommended and overturn the Initial Decision," after having made the narrow point in the preceding sentence that "we urge the Board to reverse the monetary sanction in it[s] entirety, because this sanction is not necessary to protect the interests of the investing public").

the objectives of the securities laws and can inflict great damage on public investors'") (quoting *Touche Ross & Co., Inc. v. SEC*, 609 F.2d 570, 581 (2d Cir. 1979)). He failed to meet his professional obligations on two different audits in multiple, fundamental respects, despite his 35 years of experience in the profession. *See Hatfield*, 2013 SEC LEXIS 1954, *91 (imposing permanent bar on "experienced auditors, who nevertheless knowingly, intentionally, and repeatedly failed to exercise the basic professional skepticism and due care that are the touchstones of an auditor's responsibilities"); *Moore*, PCAOB File No. 105-2012-004 at 48, 50 (imposing bar with leave to petition to associate after two years for reckless auditing standards violations where respondent was "an experienced auditor," which "should have helped equip her to understand her auditing responsibilities"); *see also Dearlove*, 2008 SEC LEXIS 223, *109, *111 (imposing a bar from appearing or practicing before the SEC with leave to seek reinstatement after four years for having "violated fundamental principles of auditing" despite "lengthy audit experience"); *James Thomas McCurdy, CPA*, SEC Rel. No. 34-49182, 2004 SEC LEXIS 221, *29 (Feb. 4, 2004) (auditor's "lengthy experience makes his failure to conduct the audit in accordance with applicable professional standards particularly troublesome"), *aff'd*, 396 F.3d 1258 (D.C. Cir. 2005). Stewart's arrangement with Harris to do minimal work on the audits and extreme lack of diligence during the audits betrays an approach to auditing issuers that is "perfunctory at best" (*McCurdy*, 396 F.3d at 1264) and created an "obvious, significant, and ongoing risk to investors" who were entitled to believe that the financial statements had been audited with due professional care (*Hatfield*, 2013 SEC LEXIS 1954, *85-*86). The more serious a violation, the stronger the inference that it will be repeated. *See generally Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004).

Stewart, in the face of overwhelming, uncontradicted evidence, insists that his minimal and deeply flawed conduct in the two audits satisfies PCAOB standards and characterizes this case as merely that each audit "was not a perfect audit" and "there's a number of things that could be done better." Tr. 234-36. That does not begin to describe the problem. His demonstrated lack of appreciation for the nature, gravity, and extent of his failures strongly suggests that, if given the chance, he would repeat them. *See, e.g., ZPR Inv. Mgmt. Inc.*, SEC Rel. No. 40-4249, 2015 WL 6575683, *29 (Oct. 30, 2015) ("failure to recognize the wrongfulness of…conduct is relevant to our consideration of the public interest and demonstrates a risk of future violations"), *aff'd in relevant pa*rt, 861 F.3d 1239, 1255 (11th Cir. 2017)); *Michael C. Pattison, CPA*, SEC Rel. No. 34-67900, 2012 SEC LEXIS 2973, *41 (Sept. 20, 2012) (same).

Stewart contends that he "poses no substantial risk of harm to those who rely on the integrity of audit reports" because the Hitor audit report contained a going concern paragraph and thus "appropriately communicated the negative financial condition of the Client." Br. 23. But he readily admitted that Hitor had received such a paragraph "every year" since it went public in 2006, which he stated is "fairly common for development stage companies." Tr. 61; *see* Ex. J-15 at 9. This undermines his suggestion that investors were sufficiently alerted to anything more particular about Hitor's financial condition for the years at issue here. Indeed, the audit report did not merely communicate the auditor's "substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time" (AU § 341.02); it also expressed an unqualified opinion (*see* AU § 508), which was subject to reliance in its own right.

Stewart's assumption that investors, market professionals, and issuers can have no meaningful interest in the reliability of detailed information about a public company's financial condition, and in whether there was a proper audit, so long as there is a going concern paragraph is baseless and places issuers with such an audit report and their investors in an even more precarious position. *See, e.g., Scutillo*, 2003 WL 21738818, *8 ("insertion of a going concern qualification in [audit] report did not justify [an asset] valuation" for which the auditor "had neither persuasive evidence nor sufficient competent evidential matter to support"); AU § 341.12 n.4 ("[n]othing in this section" about a going concern paragraph "is intended to preclude an auditor from declining to express an opinion in cases involving uncertainties"); *cf. Hatfield*, 2013 SEC LEXIS 1954, *87 (auditors "were not freed from the many auditing requirements they inexcusably ignored simply because [they might have required the company to] increase[] its reserve for bad debt"). Compared to an issuer not in financial distress, an issuer in financial distress may well pose additional risks that need to be addressed in an audit. *See, e.g.*, *Peat, Marwick, Mitchell & Co.*, SEC Rel. No. AS-173, 1975 WL 160439, *19 (July 2, 1975) (faulting auditor for failing to apply increasing procedures and "great[er] degree of caution, particularly since during the time in question [issuer] was experiencing financial difficulties and the prior auditors had identified some of the problems"); *Dearlove*, 2008 SEC LEXIS 223, *104 ("As audit risk increases, so does the need for care and skepticism."). Stewart's argument betrays a thoroughly erroneous view of his auditing responsibilities that underscores the need for strong sanctions to encourage him and others similarly situated to take those responsibilities seriously, no matter the size or condition of the client whose financial statements are under audit. *See Dearlove*, 2008 SEC LEXIS 223, *20, *78-79 (auditing standards "apply to audits of all sizes and all levels of complexity").

In briefing, Stewart additionally asserts that he poses no future threat to investors because, at "near[ly] seventy years old," he is "retiring," "has transitioned all of his clients to other CPA firms," and so he "will not be accepting new public company clients nor will he be issuing any new opinions for public companies." Reply 3-4. In contrast, at the hearing, he could only state under oath that he planned to retire soon but the "transition is going slower than [he] had anticipated." Tr. 244. He claimed that "definitely within two years I'll be out and [another CPA will] take over." *Id*. But stated intentions of leaving, and even voluntary absences from, issuer audit work are not enforceable and do not establish that the person will not resume such work. *See Mark*

E. Laccetti, CPA, PCAOB File No. 105-2009-007 at 96 (Jan. 26, 2015), *aff'd*, SEC Rel. No. 34-78764, 2016 WL 4582401 (Sept. 2, 2016), *appeal filed on other grounds*, *Laccetti v. SEC*, No. 16-1368 (D.C. Cir. Oct. 31, 2016). While Stewart states he is no longer auditing issuer clients, he nevertheless maintains an active CPA license with the State of Washington through June 2019 "to practice public accounting." *See* note 2 above. Even if his license should lapse, that does not preclude his return to auditing public companies. *See* Wash. Admin. Code 4-30-124 (reinstatement procedures); *see also Russell Ponce*, SEC Rel. No. 34-43235, 2000 SEC LEXIS 1814, *47 (Aug. 31, 2000) (noting that, although respondent "ha[d] not renewed his CPA license," he could resume auditing by seeking reinstatement with state authorities). Stewart does not contend that he anticipated entering into the special arrangement to audit Hitor, which yielded him roughly $3,000 for about four hours of his time, nor is there evidence that, at only 67, he would not similarly find attractive and entertain discrete issuer audit projects even if he did retire from general practice.[15/]

Based on the facts and circumstances of this case, we find that Stewart poses too great a risk to investors to be in a position to continue auditing public companies until appropriate sanctions provide a reason to believe he can and would do so in compliance with PCAOB standards. We accordingly find it appropriate in the public interest to bar Stewart from association with a registered public accounting firm. By design and execution of the 2011 Hitor reaudit and the 2012 Hitor audit, Stewart effectively eliminated the engagement partner from the audit process, thereby demonstrating an approach to auditing that is antithetical to fundamental precepts. *See, e.g.*, AU § 150 (first standard of fieldwork); AS No. 10 ¶ 3 (stating that the "engagement partner is responsible for the engagement and its performance" and therefore "is responsible…for compliance with PCAOB standards"); AS No. 10, App. A (engagement partner has "primary responsibility for the audit"). Such conduct undercuts public trust and "confidence…in the integrity of the financial reporting process" and in the reliability of financial information needed "[f]or the market to operate efficiently—indeed, for it to operate at all." *See McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005) ("Investor confidence is bolstered by the knowledge that public financial statements have been subjected to the rigors of independent and objective investigation and analysis."); *Marrie*

15/ In addition, we may take official notice that in a June 27, 2017 Form 8-K available on the SEC's EDGAR database, In Media Corp. referred, in announcing a change of auditors, to its "Board's understanding that [George Stewart, CPA] <u>intends to</u> cease, <u>or at least greatly curtail</u>, providing public company accounting work as part of his practice" (emphasis added); attached was a November 29, 2016 letter from Stewart stating, "We agree with the statements concerning our Firm in such Form 8-K." *See* https://www.sec.gov/Archives/edgar/data/1399488/000107878217001244/f8k091117_8k.htm (last visited on Dec. 12, 2017).

v. SEC, 374 F.3d 1196, 1200 (D.C. Cir. 2004); *Philip L. Pascale*, SEC Rel. No. 34-51393, 2005 SEC LEXIS 639, *47 (Mar. 18, 2005); *see Hatfield*, 2013 SEC LEXIS 1954, *90 ("[R]egulators and the investing public…'rely heavily on [auditors] to assure corporate compliance with federal securities law requirements and disclosure of accurate reliable information.'").

The initial decision deemed it appropriate to bar Stewart from association with a registered public accounting firm with the proviso that he could petition the Board to associate after three years but would be restricted for two additional years from associating as an engagement partner or an engagement quality reviewer on any issuer audit, from exercising authority to sign a registered public accounting firm's name to an audit report for any issuer, and from consenting to an issuer's use of a previously issued audit report. I.D. 38. Although Stewart's sanctions arguments appear to be specifically directed at the civil money penalty, part of our review, as noted in our briefing schedule order, is to "determine what sanctions, if any, are appropriate in this matter." *See* R.D. 40 (citing PCAOB Rule 5460(d)); *see generally, e.g., vFinance Investments, Inc.*, SEC Rel. No. 34-62448, 2010 WL 2674858, *14 (July 2, 2010) (noting, in connection with the point that "[i]n granting Respondents' petition for review, we determined on our own motion to review 'what sanctions, if any, are appropriate in this matter,'" that "[w]hen Congress grants an agency the responsibility to impose sanctions to achieve the purpose of a statute, 'the relation of remedy to policy is peculiarly a matter for administrative competence'") (quoting *Butz v. Glover Livestock Comm'n Co., Inc.* 411 U.S. 182, 185 (1973) (internal citations and quotation omitted)).

Given the gravity of Stewart's misconduct, the likelihood of recurrence, and the need to protect investors demonstrated by the record, we determine that he should not be granted leave to petition to associate with a registered public accounting firm in any capacity until after five years. The sanction imposed in the initial decision does not fully reflect the implications of the findings of violations for the determination of Stewart's state of mind and the level of sanction. The bar and proviso we impose, for Stewart's prearranged abandonment of any meaningful effort to carry out his auditing responsibilities in each of two separate audit years, is consistent with the range of sanctions imposed in other adjudicated auditing cases.[16/]

[16/] *See, e.g., Moore,* PCAOB File No. 105-2012-004 at 48 (barring auditor from association with a registered public accounting firm, with proviso that she may petition to associate after two years and that weight will be given in considering such petition to completion by her of 50 hours of professional education, and restricting her activities for two additional years for misconduct in one audit); *Laccetti*, PCAOB File No. 105-2009-007 at 96 (barring auditor, with leave to petition to associate after two years, and imposing an $85,000 civil penalty, for misconduct in one audit); *S.W. Hatfield, CPA*, PCAOB File No. 105-2009-003, at 9-10, 22, 25, 27 (Feb. 8, 2012) (permanent bar

It is also appropriate to censure Stewart to further impress upon him the egregiousness of his violations and the seriousness of his auditing responsibilities. A censure additionally serves to '"notif[y] the public of [Stewart's] past misconduct' even after the terms of the other sanctions have been fulfilled." *Moore*, PCAOB File No. 105-2012-004 at 51 (quoting *Salvatore F. Sodano*, SEC Rel. No. 34-59141, 2008 WL 5328801, *3 (Dec. 22, 2008)); *see, e.g., Philip L. Spartis*, SEC Rel. No. 34-64489, 2011 WL 1825026, *13 (Dec. 1, 2010) ("censures…alert the public, including other [regulatory authorities], of the unacceptability of [the actor's] conduct").

Further, Stewart's conduct warrants the imposition of a $25,000 civil penalty. In the Sarbanes-Oxley Act, Congress underscored the seriousness with which it viewed auditor misconduct by authorizing the Board to impose "disciplinary or remedial sanctions" that include, for the period at issue here, civil money penalties of up to $900,000 per violation against a natural person, as well as a temporary or permanent bar from association with any registered public accounting firm. *See* Section 105(c)(4) & (5), 15 U.S.C. 7215(c)(4) & (5); 17 C.F.R. 201.1001, Table I (statutory inflation adjustment); *see Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 485 (2010) (observing panoply of sanctions available in PCAOB disciplinary proceedings); *see also* S. Rep. No. 107-205 at 10-11 (describing Sarbanes-Oxley Act as authorizing "a full range of sanctions," including "'meaningful,'" "substantial" civil money penalties). A $25,000 civil penalty is well within the authority granted to the Board under the statute and, for many reasons, is appropriate under the circumstances. *See, e.g., Laccetti*, PCAOB File No. 105-2009-007 at 96-97 ($85,000 civil penalty imposed for violations in single audit was both "at the low end of the range of the heightened civil penalties authorized by the Sarbanes-Oxley Act for each violation involving the level of [reckless or repeatedly negligent] misconduct found here and less than the maximum civil money penalty authorized by the statute for a single violation not even reaching that threshold").[17/]

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determined to be appropriate for auditor misconduct in three audits for two issuers, including admittedly "roll[ing] over" when an SEC filing was made that the auditors "knew was false and misleading" by issuer that the auditors believed was "a 'scam'" and believed was managed by persons who had "no intent to run [a] company" but "want[ed] to get filings into the marketplace as quick as possible" to facilitate a "pump and dump" scheme), *aff'd*, 2013 SEC LEXIS 1954; *see also Dearlove*, 2008 SEC LEXIS 223, *111 & n.120 (canvassing sanctions in contested Rule 102(e) auditor cases from bars with leave to seek reinstatement after one to five years to permanent bars and barring auditor with leave to seek reinstatement after four years for misconduct in one audit).

[17/] *See also, e.g., PTR, Inc. v. SEC*, 159 Fed. App'x 338, 344 (3d Cir 2005) (unpublished) (sustaining SEC's determination that a FINRA fine and suspension "were reasonably necessary to impress upon [respondents] the necessity of strict compliance

Stewart demonstrated a reckless, if not intentional, disregard of fundamental auditing standards. His misconduct created a significant risk of substantial harm to investors that necessarily flows from audit reports founded on his extreme departures from PCAOB standards. A $25,000 civil penalty, together with the other sanctions we impose, will encourage more rigorous compliance with auditing standards by Stewart, if he seeks to associate with a registered public accounting firm in the future, and by other issuer auditors. Even if his present intention were to retire permanently from any public company audit work, the record shows that he accepted some $3,000 to do next to nothing on two issuer audits at a late stage of his career. Tr. 239-40. The need to deter such behavior is high, both specifically and generally. An auditor with Stewart's years of experience should not be incentivized to act so deleteriously during issuer audits because he or she will soon be exiting the field and may believe an associational bar would have little or no impact on him or her. We have calibrated this sanction to fit the particular facts here, even if "imposing a larger penalty in this case might provide an even greater deterrent against similar [misconduct]." *See R.E. Bassie & Co.*, SEC Rel. No. AAE-3354, 2012 SEC LEXIS 89, *3, *51-*52 (Jan. 10, 2012) ("a civil penalty of $75,000 appears sufficient to have a deterrent effect on a firm such as Bassie's," a sole proprietorship); *cf. FCS Sec.*, SEC Rel. No. 34-64852, 2011 WL 2680699, *9 (July 11, 2011) (sustaining FINRA's sanctions determination that considered the respondent brokerage firm's "small size and lack of business" as one factor in reaching the appropriate level of fine to impose).

Stewart contends that a $25,000 civil penalty is impermissibly "punitive" "when considered with" nonmonetary sanctions that he asserts "require his ceasing to serve on audits for public companies." Br. 23-24; Reply 4. In fact, Stewart appears to urge the Board to only impose an associational bar and a censure. *See* Reply 3-5, 7. As

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with Exchange rules"); *David Adam Elgart*, SEC Rel. No. 34-81779, 2017 WL 4335050, *8 (July 28, 2017) (holding that fine and suspension will "impress upon [respondent] the need to take his responsibilities in this regard more seriously in the future"); *Steven P. Sanders*, SEC Rel. No. 34-40600, 1998 WL 741105, *12 (Oct. 26, 1998) (determining that "a substantial fine is necessary here to impress upon [respondent] and others in the industry the seriousness with which we view such supervisory failures"); S. Rep. No. 107-205 at 11 (noting generally that the "breadth of [the legislation's] sanctions is intended to encourage flexible and appropriate action, designed to correct if possible"); *cf. SEC v. Lipson*, 278 F.3d 656, 664 (7th Cir. 2002) (in rejecting a challenge to a stiff civil money penalty imposed by the district court on a corporate executive, explaining that the imposition of harsher sanctions is justified to bring a wrongdoer "to his senses" where "[t]he evidence against [him] was overwhelming" and yet he "insist[s] in the face of it that he is a shorn sheep" and is "the injured party" and thus "demonstrates by his obduracy the likelihood that he will repeat" the misconduct).

discussed, however, Stewart's age, asserted intentions, and the associational bar we determine to be appropriate for his violations do not necessitate a conclusion that he will never be in a position again to audit public companies, as his argument against the civil money penalty assumes. Even a permanent bar does not preclude reentry. *See* PCAOB Rule 5302(c) (Board rule governing applications by barred individuals to associate); *cf. Rizek v. SEC*, 215 F.3d 157, 161 (1st Cir. 2000) (citing SEC Rule of Practice 193, 17 C.F.R. 201.193, and noting that "the term 'permanent bar' is more than a bit of a misnomer. It does not literally mean that the sanctioned person may never reenter the securities industry."). For the reasons we have discussed, the civil money penalty is warranted in combination with the other sanctions we impose here.

Additionally, Stewart claims he is improperly being "penalize[d]" for litigating this case, while others who have settled may have received lighter sanctions. Reply 5-7. Specifically, Stewart asserts he cannot receive any greater sanctions than the sanctions to which the Harris Firm and Harris agreed when they settled a partly related disciplinary action brought against them by the Board. Brief 23-24; Reply 1-2. According to Stewart, any suggestion by the Division or the initial decision that he could receive a "monetary sanction" that "exceed[s] that imposed on his employer (Harris) violates the Bylaws and Rules of PCAOB," citing PCAOB Rule 5205(c)(4) for the point that a "rejected offer [of settlement] shall not constitute a part of the record in any proceeding against the person making the offer" and citing comments to the rule for the point that "the content of settlement negotiations would not be introduced as evidence in Board proceedings." Reply 6. Stewart's argument misses the mark.

In the first place, the record does not include any offer of settlement (rejected or otherwise) from Stewart (*see* R.D. 21b; R.D. 37), and no such offer, even if it existed, has played any part in our decision of this case. As to the settlement with the Harris Firm and Harris, it was Stewart who brought that up as relevant to the appropriate sanction in this proceeding, raising it as an argument in his post-hearing brief to the hearing officer. R.D. 34 at 24 ("Notwithstanding this list of unrelated cases, the Division makes no reference to the one settled disciplinary matter that is directly relevant to the facts in this action-the settled disciplinary action against the Harris Firm. *See Harris & Gillespie CPAs*, PLLC, Rel. No. 105-2015-011 (PCAOB June 16, 2015).").[18/]

[18/] Not only did Stewart cite a settled, rather than an adjudicated, case, which is problematic in itself, but also he selectively cited that one matter, making no mention of settled disciplinary matters such as, for example, *Randall A. Stone, CPA*, PCAOB Rel. No. 105-2014-007 (July 7, 2014) (sanctions included a $50,000 civil penalty for certain violations of PCAOB standards in connection with one audit and a consent to incorporate by reference the audit report for that audit in a Form S-8 registration statement); *Ernst & Young LLP*, PCAOB Rel. No. 105-2012-001 (Feb. 8, 2012) (sanctions included a $50,000 civil penalty on lead engagement partner for violations in

Yet Stewart does not compare the particulars of his conduct to the particulars of the conduct addressed by that settlement, and, in elsewhere insisting that no civil money penalty is warranted for his own conduct, ignores that the settlement included a $15,000 civil penalty. Stewart also ignores that "'the appropriate sanction depends on the facts and circumstances of each particular case and cannot be determined precisely by comparison with actions taken in other proceedings.'" *Hatfield,* 2013 SEC LEXIS 1954, *95 (citation omitted). There is no obligation to make sanctions uniform. *Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010); *Geiger*, 363 F.3d at 488. Comparisons between litigated and settled cases are particularly problematic because "[l]itigated cases typically present a fuller, more developed record of facts and circumstances for purposes of assessing appropriate sanctions than do settled matters" (*Pattison*, 2012 SEC LEXIS 2973, *49 (citing *Nassar and Co., Inc.*, n.37 (1978), *aff'd*, 600 F.2d 280 (D.C. Cir. 1979)) and "settled cases take into account pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings" (*Hatfield*, 2013 SEC LEXIS 1954, *95 (those "'who offer to settle may properly receive lesser sanctions than they otherwise might have"); *accord, e.g., Orkin v. SEC*, 31 F.3d 1056, 1067 (11th Cir. 1994); *Amato v. SEC*, 18 F.3d 1281, 1284 (5th Cir. 1994); *Gary M. Kornman*, SEC Rel. No. 34-59403, 2009 WL 367635, *9 (quoting *Stonegate Sec., Inc.*, SEC Rel. No. 34-44933, 2001 WL 1222203, *4 (Oct. 15, 2001)), *aff'd*, 592 F.3d 173, 188-89 (D.C. Cir. 2010)). Here, we have made extensive findings about Stewart's misconduct and carefully considered the public interest, based on a full record, specific to this case, that Stewart was given every opportunity to develop.

In sum, the sanctions we impose in this case serve to protect against Stewart's demonstrated capacity for the conduct at issue and to encourage more rigorous compliance by him and others with their responsibilities under PCAOB auditing standards. The sanctions protect investors and further the public interest, and none of Stewart's arguments, and none of the circumstances presented by this case, suggest that the sanctions are in any way excessive or oppressive. *See* 15 U.S.C., 7217(c)(3).

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three audits); *Thomas J. Linden, CPA*, PCAOB Rel. No. 105-2009-004 (Aug. 11, 2009) (sanctions included a $75,000 civil money penalty on engagement partner for violations in two audits); *Christopher E. Anderson, CPA,* PCAOB Rel. No. 105-2008-003 (Oct. 31, 2008) (sanctions included a $25,000 civil money penalty on engagement partner for violations in one audit).

VII.

As set forth above, we have found that the Division proved by a preponderance of the evidence that Stewart violated PCAOB rules and auditing standards, as charged in the OIP, and we have determined appropriate sanctions for those violations.

An appropriate order will issue.[19/]

By the Board.

[19/] We have considered all of the parties' contentions regarding the issues addressed in this opinion and we have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of George W. Stewart, Jr., CPA, Respondent	PCAOB File No. 105-2015-016 **ORDER IMPOSING SANCTIONS** December 15, 2017

On the basis of the Board's opinion issued this day it is

ORDERED that George W. Stewart, Jr. is barred from associating with any registered public accounting firm, provided that, after five (5) years, he may petition for Board consent to associate with a registered public accounting firm; and it is further

ORDERED that George W. Stewart, Jr. is censured; and it is further

ORDERED that George W. Stewart, Jr. shall pay a civil money penalty in the amount of $25,000 by (a) United States postal money order, certified check, bank cashier's check, or bank money order, (b) made payable to the 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 George W. Stewart 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 Respondent does not file an application for review by the Securities and Exchange Commission (Commission) and the Commission does not order review of the sanction on its own motion, the effective date of the sanction 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 Respondent files an application for review by the Commission or the Commission orders review of the sanction, the effective date of the sanction shall be the date the Commission lifts the stay imposed by Sarbanes-Oxley Act Section 105(e), 15 U.S.C. 7215(e).

By the Board.

Phoebe W. Brown
Secretary

December 15, 2017