1666 K Street NW
Washington, DC 20006
Office: (202) 207-9100
Fax: (202) 862-8430
www.pcaobus.org

ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS AND IMPOSING SANCTIONS

*In the Matter of David M. Burns, CPA,*

*Respondent.*

PCAOB Release No. 105-2017-055

December 19, 2017

By this Order, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") is: (1) censuring David M. Burns, CPA ("Burns" or "Respondent"); (2) barring Burns from being an associated person of a registered public accounting firm;[1] (3) if Burns is permitted to associate once again with any registered public accounting firm, limiting his activities in connection with any "audit," as that term is defined in Section 110(1) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), until two (2) years from the date of this Order, by prohibiting Burns from serving in certain capacities in any audit as described in Section IV herein; and (4) imposing on Burns a civil money penalty in the amount of $15,000.

The Board is imposing these sanctions on the basis of its findings that Burns violated PCAOB rules and auditing standards in connection with the integrated audit of The Bancorp, Inc.'s December 31, 2013 financial statements and internal control over financial reporting ("ICFR").

**I.**

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

**II.**

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent has submitted an Offer of Settlement ("Offer") that the Board has

[1] Burns may petition for Board consent to associate with a registered public accounting firm after one (1) year from the date of this Order.

determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.[2]

**III.**

On the basis of Respondent's Offer, the Board finds that:[3]

**A. Respondent**

1. David M. Burns, age 58, of Glen Mills, Pennsylvania, is a certified public accountant licensed by the Pennsylvania State Board of Accountancy (License No. CA022856L). Burns joined Grant Thornton LLP ("Grant Thornton") in 1986 and became an audit partner in the Firm's Philadelphia office in 1998. Burns was the engagement partner on Grant Thornton's audit of the December 31, 2013 financial statements and ICFR of The Bancorp, Inc. ("Bancorp" or "Company") and its reviews of Bancorp's March 31, 2014 and June 30, 2014 financial statements. Burns, as engagement partner, authorized the issuance of Grant Thornton's audit report containing an unqualified opinion on Bancorp's December 31, 2013 financial statements and ICFR. At all relevant times, Burns was an audit partner in the Philadelphia office of Grant Thornton and an associated person of a registered public accounting firm as that term is defined by Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i). Burns retired from Grant Thornton effective July 31, 2016.

---

[2] The findings herein are made pursuant to Respondent's Offer and are not binding on any other persons or entities in this or any other proceeding.

[3] The Board finds that Respondent's conduct described in this Order meets the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5), which provides that certain sanctions may be imposed in the event of: (1) intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard; or (2) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

**ORDER**

**B. <u>Relevant Entities</u>**

2. Grant Thornton LLP is a limited liability partnership organized under the laws of the state of Illinois, and headquartered in Chicago, Illinois. Grant Thornton registered with the Board on September 24, 2003, pursuant to Section 102 of the Act and PCAOB rules.[4] Grant Thornton has served as Bancorp's independent auditor since 2000.

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

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

**C. <u>Summary</u>**

5. This matter concerns Burns's violations of PCAOB rules and auditing standards in connection with the audits of Bancorp's December 31, 2013 financial statements and ICFR ("2013 audit"). Specifically, Burns, among other things, failed to properly supervise the engagement team, failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence concerning the reported value of Bancorp's net loans, the effectiveness of Bancorp's controls relating to its allowance for loan and lease losses ("ALLL"), and the reasonableness of Bancorp's ALLL – a known significant risk and significant accounting estimate. As a result of his failure to perform the audit in conformity with PCAOB standards, Burns lacked an appropriate basis to authorize the issuance of Grant Thornton's unqualified opinion on Bancorp's 2013 financial statements and ICFR.

---

[4] <u>See</u> *Grant Thornton LLP*, PCAOB Release No. 105-2017-054 (Dec. 19, 2017) (finding that Grant Thornton violated PCAOB rules, quality control standards, and auditing standards). Grant Thornton's violations of PCAOB rules and standards do not excuse Burns's failures in connection with the supervision and execution of the 2013 audit of Bancorp.

**ORDER**

6. On April 1, 2015, Bancorp announced that its previously issued financial statements for the years ended December 31, 2012 and 2013 and the quarterly financial statements within those years and for the first three quarters of 2014 should no longer be relied on because certain provisions for loan losses related to commercial loans were taken in incorrect periods. Ultimately, the restatement resulted in a $141 million reduction in Bancorp's net loans as of December 31, 2013, as well as increases in Bancorp's provision for loan and leases losses of $28.9 million (or 98 percent) during 2013 and $90.5 million (or 403 percent) during 2012, respectively.[5]

**D. <u>Burns Violated PCAOB Rules and Auditing Standards in Performing the 2013 Audit of Bancorp's Financial Statements and ICFR</u>.**[6]

**a. <u>Background</u>**

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

8. To reflect the inherent credit risk associated with its loan portfolio, Bancorp recorded an ALLL to cover probable losses that existed in the loan portfolio as of each period end. Bancorp's ALLL comprised two components, specific reserves based on potential losses on individually classified loans, and a general loss reserve for non-classified loans. Bancorp calculated the specific reserve portion of the ALLL by first

---

[5] Although Bancorp initially announced that the restatement would impact only its December 31, 2012 and 2013 financial statements, the Company ultimately restated its December 31, 2010 and 2011 financial statements as well.

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

**ORDER**

identifying problem loans or leases through delinquency monitoring and loan file reviews. For loans risk rated special mention or below, Bancorp analyzed the "most probable sources of repayment and liquidation of collateral" to assess whether a reserve was required. To the extent the expected cash flows or fair value of collateral was less than the loan balance, Bancorp established an impairment reserve.[7]

9. Bancorp calculated its general reserve portion of the ALLL based on the application of historical loss experience and other factors to pools of loans with similar characteristics. Bancorp then adjusted the general reserve to reflect current economic conditions, current loan portfolio performance, loan concentrations, and other factors identified by management.[8] Burns understood that the loss experience or loss factors Bancorp used to calculate the general reserve were determined by calculating historical charge-off rates for each type of loan by risk rating. Burns also understood that Bancorp's loan risk ratings were determined based on delinquency status and/or Bancorp's loan review process. In determining its ALLL, as well as for disclosure purposes, Bancorp needed to determine whether a loan should be classified as a troubled debt restructuring ("TDR"). Such a classification was appropriate if Bancorp, in the course of restructuring a loan, "for economic or legal reasons related to the [borrower's] financial difficulties grant[ed] a concession to the [borrower] that it would not otherwise consider."[9] Accordingly, as Burns was aware, Bancorp relied on its loan review process, risk ratings, and appraisals to calculate and assess the sufficiency of its ALLL, including to determine whether a loan should be classified as a TDR.

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

11. On April 1, 2015, Bancorp announced that its previously issued financial statements for the years ended December 31, 2012 and 2013 and the quarterly financial statements within those years and for the first three quarters of 2014 should no

---

[7] See Bancorp Form 10-K, at 51-52 (Mar. 17, 2014).

[8] See id.

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

longer be relied upon. On September 28, 2015, Bancorp filed restated financial statements, reducing its net loans by $141 million as of December 31, 2013. In addition, the Company's provision for loan and leases losses increased by $28.9 million during 2013 and $90.5 million during 2012. As a result of the increased provisions, Bancorp reported net losses for both 2013 and 2012.

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

**b. Applicable PCAOB Rules and Auditing Standards**

13. PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards.[10] An auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.[11] Among other things, PCAOB standards require an auditor to exercise due professional care, exercise professional skepticism, and plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion.[12]

14. The engagement partner is responsible for the engagement and therefore is "responsible for proper supervision of the work of engagement team members and for compliance with PCAOB standards."[13] As part of those responsibilities, the engagement

---

[10] See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

[11] See AU § 508.07, *Reports on Auditing Financial Statements*.

[12] See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230.01, *Due Professional Care in the Performance of Work*; Auditing Standard No. 15 ¶ 4, *Audit Evidence* ("AS No. 15").

[13] See Auditing Standard No. 10, *Supervision of the Audit Engagement* ("AS No. 10"), ¶ 3.

partner is required to (i) inform engagement team members of their responsibilities, (ii) direct engagement team members to bring significant accounting and auditing issues to his attention, and (iii) review the work of engagement team members to evaluate whether: (1) the work was performed and documented; (2) the objectives of the procedures were achieved; and (3) the results of the work supported the conclusions reached.[14] In determining the extent of supervision necessary, Burns was also required to take into account (i) the nature of the company, (ii) the nature of the assigned work, (iii) the risks of material misstatement, and (iv) the knowledge, skill, and ability of each engagement team member.[15]

15. Management representations "are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit."[16] Under PCAOB standards "[t]he auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest."[17]

16. In designing the audit procedures to be performed, PCAOB auditing standards require that the auditor "[o]btain more persuasive audit evidence the higher the auditor's assessment of risk."[18] PCAOB standards further require that an auditor evaluate the results of the audit to determine whether the audit evidence obtained is sufficient and appropriate to support the opinion to be expressed in the auditor's report.[19] The "auditor should take into account all relevant audit evidence, regardless of

---

[14] See AS No. 10 ¶ 5.

[15] See AS No. 10 ¶ 6.

[16] See AU § 333.02, *Management Representations.*

[17] See AU § 230.09.

[18] See Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, ¶ 9; see also Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit of Financial Statements* ("AS No. 5"), ¶ 46 ("As the risk associated with a control being tested increases, the evidence that the auditor should obtain also increases.").

[19] See Auditing Standard No. 14, *Evaluating Audit Results* ("AS No. 14"), ¶ 2.

whether it appears to corroborate or to contradict the assertions in the financial statements."[20] Further, if audit evidence obtained from one source is inconsistent with that obtained from another, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.[21] PCAOB standards further require the auditor to modify the overall audit strategy and the audit plan "if circumstances change significantly during the course of the audit, including changes due to a revised assessment of the risks of material misstatement."[22]

17. Under PCAOB auditing standards, the auditor is required to assess the sufficiency of substantive tests of details. When planning a sample for a substantive test of details, the auditor should individually examine "those items for which, in his judgment, acceptance of some sampling risk is not justified."[23]

18. PCAOB standards require that the auditor form an opinion on the effectiveness of ICFR based on the auditor's evaluation of evidence obtained from all sources, including the auditor's testing of controls, misstatements detected during the financial statement audit, and any identified control deficiencies.[24] In conducting an integrated audit, the auditor should design his or her testing of controls to obtain sufficient evidence to support 1) the auditor's opinion on ICFR and 2) the auditor's control risk assessment for purposes of the financial statement audit.[25]

19. If an auditor plans to assess control risk at less than the maximum, and modifies the nature, timing, and extent of planned substantive procedures based on that

---

[20] See AS No. 14 ¶ 3.

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

[22] See Auditing Standard No. 9, *Audit Planning* ("AS No. 9"), ¶ 15.

[23] See AU § 350.21, *Audit Sampling*.

[24] See AS No. 5 ¶ 71.

[25] See AS No. 5 ¶ 7.

lower assessment, "the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance."[26] An auditor's assessment of control risk should include an evaluation of "evidence obtained from all sources, including the auditor's testing of controls for the audit of internal control and the audit of financial statements, misstatements detected during the financial statement audit, and any identified control deficiencies."[27] Auditors should also incorporate knowledge obtained in past audits of the issuer's ICFR into the decision-making process for determining the testing required during the current year audit.[28]

20. Auditors are required to assess control risk at the maximum for relevant assertions when controls necessary to address the risk of material misstatement are missing or ineffective, or when the auditor has failed to obtain sufficient appropriate evidence to support a control risk assessment below the maximum.[29] When an auditor identifies control deficiencies, PCAOB standards require that the auditor evaluate the severity of those deficiencies, and revise the control risk assessment and modify planned substantive procedures as necessary.[30]

---

[26] See AS No. 13 ¶ 16*.* "A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met." AS No. 5 Appx. A ¶ A3. "A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively." Id.

[27] See AS No. 13 ¶ 32*.*

[28] See AS No. 5 ¶ 57.

[29] See AS No. 13 ¶ 33.

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

**ORDER**

21. When planning and performing audit procedures to evaluate accounting estimates, PCAOB standards require the auditor to "consider, with an attitude of professional skepticism, both the subjective and objective factors" on which management's estimate is based.[31] When management's estimate involves fair value measurements, the auditor must comply with PCAOB auditing standards concerning the auditing of fair value measurements and disclosures.[32] Under those standards, when a fair value measurement, such as an appraisal, is dated prior to the relevant financial reporting date, the auditor is required to obtain" evidence that management has taken into account the effects of events, transactions, and changes in circumstances occurring between the date of the fair value measurement and reporting date."[33] The auditor also evaluates whether "[m]anagement's assumptions are reasonable and reflect, or are not inconsistent with, market information" and whether "[m]anagement used relevant information that was reasonably available at the time."[34]

22. As described below, Burns failed to comply with these and other PCAOB auditing standards in connection with the audit procedures performed and the opinions he authorized on the 2013 Bancorp audit.

### c. Burns Violated PCAOB Rules and Auditing Standards

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

---

[31] See AU § 342.04, *Auditing Accounting Estimates.*

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

[33] See AU § 328.25*.*

[34] See AU § 328.26.

**ORDER**

24. In planning the 2013 audit of Bancorp, Burns adopted a controls reliance approach to auditing the reasonableness of the valuation of Bancorp's ALLL. As the audit progressed, Burns failed to obtain sufficient appropriate audit evidence to support his assertion that Bancorp's controls over the valuation of the ALLL were designed and operating effectively. Specifically, Burns failed to properly test, or ensure the engagement team properly tested, the design and operating effectiveness of Bancorp's loan review and collateral monitoring controls, as well as the operating effectiveness of Bancorp's controls over the maintenance of loan files and identification and measurement of impairment.

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

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

27. Burns's violations stemmed from, among other things, his failure to reasonably supervise and review the work of engagement team members. Burns delegated many of his supervisory responsibilities to the senior manager, yet failed to develop a sufficient understanding as to how the senior manager carried out those duties. Burns then failed to properly review the work of inexperienced team members.

28. As a result, Burns failed to obtain sufficient appropriate audit evidence to support Grant Thornton's opinions on Bancorp's 2013 financial statements and on the effectiveness of Bancorp's ICFR. Burns's substantial audit experience, which spanned

three decades, makes his failure to conduct the 2013 Bancorp audit in accordance with PCAOB standards especially troubling.[35]

### i. <u>Assignment of Significant Engagement Responsibilities</u>

29. Burns violated PCAOB auditing standards by failing to properly supervise and review the work of the engagement team.[36] Burns, as engagement partner, was responsible for the assignment of tasks to, and supervision of, the members of the engagement team and, as permitted, Burns sought the assistance of the senior manager on the engagement in fulfilling those responsibilities. Among other tasks, Burns delegated to the senior manager the responsibility for assigning test work to the staff on the engagement. Burns, however, failed to properly supervise the senior manager and failed to develop a sufficient understanding of who was performing which audit procedures or the skills of the individuals performing the procedures.

30. Despite the risks associated with Bancorp's ALLL and ALLL-related controls, the senior manager assigned the responsibility for performing test work over highly subjective areas, including the assignment of risk ratings, the identification and quantification of impairment, the identification of TDRs, and the evaluation of appraisals, to staff with little to no prior experience in auditing the ALLL for a financial services company. Indeed, the senior manager was aware that the junior staff lacked experience to draw certain audit conclusions, as he acknowledged in an email to Burns during the audit: "[T]he staff in the field are too inexperienced to understand what they've already done in order to draw connections between the different procedures and risks."

31. Burns further violated PCAOB auditing standards because he failed to inform engagement team members of their responsibilities. Burns did not instruct the staff as to which procedures to perform, the objectives of those procedures, or how the procedures should be performed. Instead, Burns again relied on the senior manager but failed to develop a sufficient understanding of the instructions the senior manager provided to the staff.

32. Burns also violated PCAOB standards by failing to properly assess the extent of supervision necessary for engagement team members to perform their work

---

[35] <u>See</u> *In re Gregory M. Dearlove, CPA*, Rel. No. 34-57244, 2008 WL 281105, at *30 and n. 119 (SEC Jan. 31, 2008).

[36] <u>See</u> AS No. 10 ¶¶ 3, 5, 6.

and form appropriate conclusions.[37] Specifically, Burns failed to adequately take into account the knowledge, skill, and ability of each engagement team member, the nature of the assigned work, and the risks of material misstatement. In particular, Burns failed to appropriately increase his level of supervision in response to the relative inexperience of the engagement team.[38]

33. Burns then failed to sufficiently 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 supported the conclusions reached.[39] In fact, Burns failed to document that he performed any review of control test work over the ALLL, even though he had identified it as a significant risk. Moreover, to the extent Burns did review work papers, he failed to review them at a level sufficient to identify the significant problems that the 2013 audit work papers contained, including factual inaccuracies, conclusions not supported by sufficient appropriate evidence, various red flags, contrary audit evidence, and indications that audit procedures had not been properly performed.

34. Burns's failure to properly supervise and review the work of staff on the 2013 audit occurred despite his having previously received criticism for similar failures. In his fiscal year 2012 performance appraisal, Burns received negative comments from a member of Grant Thornton's National Professional Practice Director Group, who criticized him for over-relying on his senior managers and for failing to delve deeply enough into audit work papers.[40] As a result, in Burns's fiscal year 2014 performance goals, the Audit Practice Leader identified increased supervision and more in-depth and timely review as areas of focus for Burns. Accordingly, Burns knew of the need to improve his supervision of staff and his review of audit work papers, but failed to do so. Indeed, Burns reviewed only a small number of work papers until late in the audit and did not take sufficient time to complete his work paper review.

---

[37] See AS No. 10 ¶ 6.

[38] During the prior year audit, the Bancorp engagement team included an experienced senior manager, experienced manager, and experienced in-charge who had been on the audit since 2008. In contrast, the 2013 engagement team included the experienced senior manager but no manager and a brand new in-charge who had never served as an in-charge on a completed audit of either a public company or a bank.

[39] See AS No. 10 ¶ 5.

[40] Grant Thornton's fiscal year runs from August 1 to July 31.

**ORDER**

35. Burns's failure to properly supervise and review the work of the engagement team contributed significantly to the audit failures described below.

### ii. <u>Burns Failed to Assess Adequately the Design and Operating Effectiveness of ALLL-Related Controls</u>

36. In performing procedures to support the financial statement and ICFR opinions, PCAOB standards required Burns to test both the design effectiveness and operating effectiveness of controls that were "important to the auditor's conclusion about whether the company's controls sufficiently address[ed] the assessed risk of misstatement to each relevant assertion."[41]

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

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

39. Further, despite evidence from the engagement team's testwork suggesting potentially ineffective controls, Burns failed to perform, or ensure the engagement team performed, sufficient procedures to assess:

- the adequacy of the timing and scope of Bancorp's loan review control;

---

[41] <u>See</u> AS No. 5 ¶ 39. To satisfy this requirement, Burns and the engagement team identified key controls for testing.

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

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

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

41. Burns and the engagement team also failed to perform sufficient procedures to support their conclusions that the controls relating to Bancorp's measurement of impairment were operating effectively. Despite having raised concerns about management's use of unsupported discounts on aged appraisals during the 2012 audit, Burns and the engagement team failed to obtain sufficient evidence that management's practice did not continue to exist in 2013. In fact, in reviewing the impairment calculation for one loan, the engagement team noted that Bancorp rejected a recent appraisal of the loan's collateral and, instead, relied on a 2007 appraisal discounted by five percent. Burns and the engagement team, however, failed to sufficiently assess whether Bancorp's actions demonstrated management bias or a control deficiency.

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

### iii. <u>Burns Violated PCAOB Standards in Evaluating Net Loans and the ALLL</u>

43. The engagement team's procedures to evaluate the reasonableness of the valuation of net loans and the ALLL likewise fell short of complying with PCAOB

**ORDER**

standards. Specifically, the small number of loans Burns and the engagement team reviewed was insufficient to address the risks presented by Bancorp's loan portfolio.

44. Further, Burns failed to sufficiently consider red flags or contrary evidence indicating that loans were impaired and/or TDRs and relied on management representations without obtaining relevant and reliable evidence to corroborate those representations. As a result, Burns failed to comply with PCAOB standards, including those requiring him to exercise due professional care and professional skepticism, obtain sufficient appropriate audit evidence, evaluate whether he obtained sufficient audit evidence, and perform procedures to resolve questions concerning inconsistent audit evidence.[42]

*The Loan Review Scope Failed to Respond to Known Risks*

45. Burns, as engagement partner, was responsible for the design and execution of audit procedures. The engagement team's substantive loan review procedures, which consisted of reviewing a random sample of 25 loans and four individually significant impaired loans, fell short of providing Burns with sufficient appropriate evidence to conclude on the reasonableness of Bancorp's reported net loans and ALLL.[43]

46. Among other things, during the 2013 audit, the engagement team, with Burns's approval:

- Substantively reviewed fewer loans than the previous year even though Burns acknowledged that there had been no change in the risk associated with Bancorp's loans from 2012;

- Failed to review any non-impaired individually significant loans or loans based on qualitative risk factors, (a) despite having reviewed 64 individually significant loans during the 2012 audit; (b) despite having

---

[42] See AU §§ 230.01, 09; AU §§ 333.03-.04; AU § 350.21; AS No. 5 ¶ 71; AS No. 14 ¶¶ 2-3, 32-36; AS No. 15 ¶¶ 4, 7, 10, 29.

[43] Moreover, Burns and the engagement team failed to select their sample to ensure that the sample was representative of the relevant population. Of the 25 loans that the engagement team reviewed as part of its random sample, 20 were direct finance leases or daily rental lines of credit even though together they only represented $195 million or 9.75 percent of the $2.0 billion loan portfolio as of December 31, 2013.

identified certain risky loans that the engagement team characterized variously as "sticky," and "problematic;" (c) despite knowing that certain loans—in fact, 30 percent of Bancorp's portfolio of Commercial Loans—had been originated prior to the 2008 financial crisis and presented a different risk profile as compared to loans that were originated afterwards; and (d) despite Grant Thornton's own guidance requiring review of "[l]oans that me[t] certain qualitative risk characteristics;" and

- Failed to properly evaluate multi-loan lending relationships, even when cross collateralization or cross default provisions were present, thus failing to consider factors necessary to conclude on the risks presented by Bancorp's multi-loan relationships and on any necessary allowance.[44]

*Burns Failed to Respond to Red Flags and Contrary Evidence During the Loan Review Procedures*

47. In reviewing the loan review procedures, Burns and the engagement team failed to identify or give appropriate weight to contradictory evidence indicating that loans were improperly risk rated, impaired, and/or were TDRs. In fact, during the 2013 loan reviews, Burns and the engagement team were aware of the following information:[45]

- For one loan that was part of a $17.8 million lending relationship, Burns had information that the borrower had insufficient income to service the interest payments on the loans yet concluded that the loans were not impaired because they were current. Burns did so despite clear indicators that the borrower was drawing on his line of credit with Bancorp to service the interest only payments on that same line of credit.

- For a second loan relationship, Burns concluded that the loans were not impaired despite the fact that two-thirds of the collateral securing certain of

---

[44] Cross collateralization is a provision in a loan agreement that gives the lender the right to use the collateral from one loan to secure another loan. Cross default is a provision in a loan agreement that states a borrower is in default on the loan if the borrower defaults on another loan.

[45] During the restatement audit, Grant Thornton relied on this same information, among other information, to concur in management's conclusion that Bancorp's ALLL needed to be restated.

the loans had been sold and the borrower had not repaid any of the principal on those loans.

- On that same loan relationship, Burns concluded that the loans were not TDRs because the loans had not been modified and the borrower was not in financial distress. Burns reached this conclusion even though his team's work papers noted that, over the lives of these loans including during 2013, the loans had been modified or extended at least seven times, the borrower was diverting proceeds from the sale of collateral to service other loans, and there had been 18 late payments on one or more of the loans in the relationship.

- On a third lending relationship Burns failed to instruct the engagement team to expand its procedures to include all loans in the relationship despite clear indicators that other loans might be impaired. Significantly, Burns knew that the guarantor of one of the loans, who was also the borrower and/or guarantor across all loans in the relationship, had made only minimal payments, had been convicted in July 2012 for his role in a kickback scheme, and was serving a five-year prison sentence. Burns was also aware, through his review of another loan, that the guarantor's wife intended to repay the loan as part of a restructuring of the borrower's debt. Despite this knowledge, Burns failed to sufficiently consider whether this information might impact other loans in the relationship.

- For one loan within another relationship, Bancorp relied on a stale pre-financial crisis appraisal to value a borrower's reported equity interest in a Las Vegas casino.[46] Burns was aware the borrower had significantly reduced the value of his reported equity interests in the casino from $66 million to $20 million, yet Burns again failed to assess whether Bancorp's use of the stale valuation indicated a potential impairment or control deficiency.[47]

---

[46] Burns also failed to perform or ensure the engagement team performed any procedures to test whether Bancorp had perfected its interest in the borrower's collateral. Had Burns done so he would have learned Bancorp's collateral rights were worthless as the company that owned the Las Vegas casino had folded in 2012 and filed for bankruptcy in 2013.

[47] Although PCAOB standards required Burns to evaluate control deficiencies identified during substantive procedures, Burns failed to identify and

**ORDER**

*Burns Inappropriately Relied on Management Representations in Concluding on his Loan Review Procedures*

48. Although Burns and the engagement team identified concealment of nonperforming loans as a fraud risk, Burns, during the engagement team's loan reviews, relied on management representations without obtaining or ensuring the engagement team obtained sufficient evidence to corroborate such representations, even when the risk of possible management bias was present:

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

- In another lending relationship, Bancorp, in measuring the necessary specific reserves, discounted a recovery strategy firm's valuation of commissions receivable (the collateral for the loans) by 30 percent. Burns concluded the specific reserves were reasonable yet failed to perform any procedures to assess the recovery strategy firm's valuation of the commissions receivable and further failed to obtain any evidence to corroborate management's 30 percent discount.[48]

---

evaluate control deficiencies that were evident during the engagement team's substantive procedures. See AS No. 5 ¶ 71 (auditors are required to evaluate evidence obtained from all sources, including any control deficiencies identified during the audit, when forming an opinion on the effectiveness of ICFR).

[48] Even though Bancorp engaged the recovery strategy firm to provide a valuation, and then used that valuation for purposes of calculating a specific reserve that Burns and the engagement team also used as evidence to support the reserve, Burns failed to identify the firm as a specialist. Accordingly, Burns violated AU § 336, *Use of a Specialist*, because Burns failed to perform or ensure the engagement team performed any procedures to (a) evaluate the professional qualifications of the recovery strategy firm engaged by Bancorp; (b) develop an understanding of the methods and assumptions used by the recovery strategy firm; and (c) test the data Bancorp provided to the recovery strategy firm. See AU §§ 336.08-.09, .12 (when an auditor uses the work

*Burns Failed to Identify and Evaluate Potential TDRs*

49. Burns likewise failed to design and perform, or ensure the engagement team performed, audit procedures to sufficiently address the risk of misstatement posed by a previously recognized TDR-related control deficiency. Because of the heightened risk associated with unidentified TDRs, Burns and the engagement team were required to obtain more persuasive evidence to support the completeness assertion associated with Bancorp's TDR disclosures.[49]

50. Burns and the engagement team, however, failed to identify and include any loans modified during the first nine months of 2013 in its population of loans subject to substantive TDR completeness procedures. Indeed, Burns and the engagement team limited the population of loans subject to test work because of the change in controls Bancorp implemented during October 2013. Thus, Burns and the engagement team failed to perform sufficient substantive testing to ensure that Bancorp's identification of TDRs for 2013 was complete.

51. Burns also failed to appropriately evaluate whether there was evidence that certain loans should have been classified as TDRs. As discussed above, in performing his review of the engagement team's loan review procedures, Burns failed to appropriately evaluate whether there was evidence that certain loans should have been classified as TDRs.

**iv. Burns Violated Audit Documentation Requirements**

52. Burns also violated PCAOB auditing standards that required the auditor to assemble for retention (referred to herein as "archive") a complete and final set of work papers (a) within 45 days of the release of its audit report; and (b) within 45 days of its

---

of a specialist as audit evidence, the auditor is required, among other things, to "consider the ... professional qualifications of the specialist in determining that the specialist possesses the necessary skill or knowledge in the particular field," obtain an understanding of the methods and assumptions used by the specialist, and conduct "appropriate tests of data provided to the specialist").

[49] For a description of the requirements related to the design of auditing procedures to respond to the auditor's assessment of risk, see AS No. 13 ¶ 9; see also AS No. 5 ¶¶ 57-58.

substantially completing field work for each of its quarterly reviews.[50] Specifically, Burns failed to (i) archive, or ensure his team archived, the first quarter 2012 and 2013 Bancorp quarterly review work papers and (ii) timely archive, or ensure his team timely archived, the 2013 Bancorp audit work papers.

53. PCAOB standards also require that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to determine who performed the work and the date such work was completed.[51] To assist engagement team members in complying with this requirement, Grant Thornton's audit software permits more than one person to sign off as preparer for a work paper and permits individuals to sign off on behalf of someone else. Despite the requirements of PCAOB standards and the functionality of the Firm's audit software, the audit in-charge signed off as the sole preparer on a significant number of work papers for which she did not perform any procedures other than opening the work paper, skimming it to confirm it was complete, and attaching it to the audit file. Of particular significance, the in-charge signed off as the sole preparer for all but four of the loan reviews performed as part of the Firm's control testing; however, she did not actually perform any procedures on those loan reviews beyond opening them and checking to see if they appeared complete and that the conclusions did not contradict the information she skimmed. Accordingly, Burns, as the engagement partner, violated PCAOB audit documentation standards by failing to ensure that the 2013 audit work papers accurately indicated who performed the work.

**v. Burns Failed to Appropriately Evaluate Facts Discovered Subsequent to Grant Thornton's 2013 Integrated Audit Report.**

54. PCAOB standards require an auditor to take certain steps when, after the auditor's report, the auditor becomes aware of information that relates to the financial statements and/or ICFR that it was not aware of at the time it issued an audit report and which is of such a nature and from a source that the auditor would have investigated it

---

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

51 See AS No. 3 ¶ 6.

had it come to the auditor's attention during the course of the audit.[52] Burns violated these standards, during the first and third quarters of 2014.

55. Prior to the restatement, during the first quarter of 2014, Bancorp recorded provisions for loan and lease losses totaling $17.3 million primarily due to three large commercial loans. At that time, Burns learned in connection with the first quarter provision taken for one relationship, that the borrower had entered into a settlement agreement with Bancorp. Burns, however, failed to sufficiently consider whether the facts related to the settlement agreement, which led to the provision, occurred prior to audit report date. Indeed, during the first quarter review, Burns failed to sufficiently consider whether those newly learned facts should have caused an earlier impairment, particularly given that he had previously known that the borrower's wife had requested, prior to December 31, 2013, that the loan relationship be restructured. Likewise, when Burns learned that Bancorp had received a new appraisal for collateral securing several of the loans, he failed to inquire as to when the appraisal was received and failed to sufficiently consider whether it was appropriate to record the additional provisions and related charge-offs prior to December 31, 2013.

56. Burns further violated PCAOB standards when he failed to sufficiently consider whether information presented in a third-party consultant report[53] indicated the existence of ALLL-related control deficiencies and possible unrecorded loan impairments as of December 31, 2013.[54] The report, which Burns obtained as part of the third quarter 2014 review procedures, noted that Bancorp's risk ratings tended to congregate too much in a specific Pass category, that the information in Bancorp's loan files was often incomplete, and that the amount of follow-up credit monitoring was limited in practice. The report recommended that a significant number of risk ratings be downgraded. The third-party that prepared the report ultimately calculated an expected material loss based primarily on the credit risk associated with the loans. Burns, however, failed to sufficiently assess whether the report's findings were based on facts that existed at or before December 31, 2013. Burns further failed to properly consider whether the report's conclusions were an indication that Bancorp's risk ratings as of

---

[52] See AU §§ 561.04-.05, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*; AS No. 5 ¶ 98.

[53] Bancorp retained a third-party consultant to conduct a review and valuation of its commercial lending portfolio in connection with its decision in the third quarter of 2014 to discontinue its commercial lending operations.

[54] Under AS 5 ¶ 98, auditors are required, consistent with AU § 561, to evaluate subsequently discovered facts that may have impacted their ICFR report.

December 31, 2013 were incorrect or that the ALLL might have been materially understated as of year-end.

**IV.**

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), David M. Burns, CPA, is hereby censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), David M. Burns, CPA, is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);[55]

C. After one (1) year from the date of this Order, David M. Burns, CPA, may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm.

D. If David M. Burns, CPA, is permitted to associate once again with a registered public accounting firm, pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(3), for a period of two (2) years from the date of this Order, his role in any "audit," as that term is defined in Section 110(1) of the Act and PCAOB Rule 1001(a)(v), shall be restricted as follows: Burns shall not (1) serve, or supervise the work of another person serving, as an "engagement partner," as that term is used in the Board's Auditing Standard No. 10 or AS 1201, *Supervision of the Audit Engagement*; (2) serve, or supervise the work of another person serving, as an "engagement quality reviewer," as that term is used in the Board's Auditing Standard No. 7 or AS 1220, *Engagement Quality Review*; (3) serve, or supervise the work of another person serving, in any role that is equivalent to, but differently denominated from, engagement partner (such

---

[55] As a consequence of the bar, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Burns. Section 105(c)(7)(B) provides: "It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any issuer, broker, or dealer in an accountancy or a financial management capacity, and for any issuer, broker, or dealer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission."

as "lead partner" or "practitioner-in-charge") or engagement quality reviewer (such as "concurring partner"); (4) exercise authority, or supervise the work of another person exercising authority, either to sign a registered public accounting firm's name to an audit report, or to consent to the use of a previously issued audit report, for any issuer, broker, or dealer; (5) serve, or supervise the work of another person serving, as the "other auditor," or "another auditor," as those terms are used in the Board's Interim Auditing Standard AU Section 543 or AS 1205, *Part of the Audit Performed by Other Independent Auditors*; or (6) serve, or supervise the work of another individual serving as a professional practice director; and

E. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $15,000 payable by David M. Burns is imposed. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. David M. Burns, CPA, shall pay this civil money penalty within 10 days of the issuance of this Order by (1) wire transfer in accordance with instructions furnished by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter, which identifies David M. Burns, CPA as a respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

December 19, 2017