UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF:	)	
Grant Thornton LLP	)	**FINAL DECISION**
External Auditor For	)	**AND ORDER**
The First National Bank of Keystone	)	**AA-EC-04-02**
Keystone, West Virginia	)	**AA-EC-04-03**

JOHN C. DUGAN, Comptroller of the Currency:

INTRODUCTION

Grant Thornton LLP ("Grant Thornton") is a nationally recognized accounting firm that conducted an external audit of First National Bank of Keystone, Keystone, West Virginia ("Keystone" or the "bank") required by a formal agreement between the bank and the Office of the Comptroller of the Currency ("OCC"). Grant Thornton issued an unqualified opinion stating that, after following Generally Accepted Auditing Standards ("GAAS"), Grant Thornton had obtained reasonable assurance that the bank's financial statements for calendar year 1998 were not materially misstated and were prepared in accordance with Generally Accepted Accounting Principles ("GAAP"). Several months later, the OCC discovered that the bank was hopelessly insolvent and in September 1999 appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver.

The OCC's Enforcement and Compliance Division ("E&C") initiated administrative enforcement proceedings against Grant Thornton by filing notices of charges seeking issuance of a cease and desist order ("C&D") to address serious deficiencies identified by the OCC in connection with Grant Thornton's audit of Keystone and assessing a $300,000 civil money penalty ("CMP"). Following a hearing, Administrative Law Judge Ann Z. Cook (the "ALJ")

issued a decision ("RD") recommending dismissal of the enforcement actions because she concluded that Grant Thornton was not an institution-affiliated party ("IAP").[1]

Upon consideration of the entire record, including the exceptions filed by the parties, the Comptroller finds as follows: In connection with the audit of Keystone, Grant Thornton acted as an IAP within the meaning of 12 U.S.C. § 1813(u)(4). Specifically, Grant Thornton, as an independent contractor for Keystone, participated in an unsafe or unsound practice by failing to comply with GAAS in planning and conducting its audit of Keystone's 1998 financial statements. Further, Grant Thornton recklessly participated in the unsafe or unsound practice by conducting the audit "in disregard of, and evidencing a conscious indifference to, a known or obvious risk of a substantial harm,"[2] that bank regulators, the bank's shareholders and the public would rely to their detriment upon financial statements that contained serious material inaccuracies.

An auditor's opinion is based upon the principle of obtaining *reasonable assurance* that the financial statements of the entity being audited are not materially misstated. Auditors do not function as insurers and their reports do not constitute a guarantee. Accordingly, an auditor does not become liable to sanctions under the laws governing the activities of insured depository institutions simply by failing to comply with the technical requirements of GAAS or merely failing to detect fraud or misstatement. It is only when the conduct of an audit for an insured

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[1] The OCC's authority to impose a CMP and issue a C&D is found at 12 U.S.C. §§ 1818(b)(1) (C&D) and 1818(i)(2)(B)(II) (CMP). Both section 1818(b)(1) and 1818(i)(2)(B)(II) apply to an IAP as defined in 12 U.S.C. § 1813(u)(4). An IAP is defined as "any independent contractor (including any . . . accountant) who . . . recklessly participates in . . . any unsafe or unsound practice . . . which caused or is likely to cause more than a minimal financial loss to, or significant adverse effect on, the insured depository institution." 12 U.S.C. § 1813(u)(4).

[2] *Cavallari v. Office of the Comptroller of the Currency*, 57 F.3d 137, 142 (2d Cir. 1995).

depository institution departs so far from the standards required by GAAS that it becomes evident that the audit was conducted in disregard of, or with conscious indifference to, the risk of harm to those who might rely on the auditor's opinion regarding the absence of material misstatements in the financial statements, that an auditor or auditing firm may become liable for sanctions under the federal banking laws. This is such a case.

The record shows that Grant Thornton recklessly participated in an unsafe or unsound practice with respect to its audit of Keystone. In the context of an acknowledged maximum risk audit, an auditor acts with conscious indifference to a known or obvious risk of substantial harm whenever the auditor fails to execute basic procedures concerning the most material entries on an insured depository institution's financial statement. This occurs when the auditor, with respect to the verification of reported assets, had in its possession evidence of the type required by GAAS that directly and unequivocally demonstrated that a bank is overstating its assets by hundreds of millions of dollars, but relies instead on evidence that does not comply with GAAS. Likewise, this occurs when the auditor, with respect to income verification, contrary to GAAS, relies upon financial data obtained from the bank that it knew or should have known was unreliable when evidence required by GAAS was readily available at the bank and would have demonstrated that the bank received almost none of the $98 million in interest income it was reporting. The record shows that this occurred in Grant Thornton's audit of Keystone.

Finally, Grant Thornton's conduct resulted in more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution. Accordingly, based upon the entire record, the Comptroller finds that Grant Thornton, as an IAP, recklessly "engaged" in an unsafe or unsound practice in conducting the "business" and "affairs" of Keystone, within the

meaning of 12 U.S.C. §§ 1818(b)(1) and 1818(i)(2)(B)(II) and, thus, should be subject to a C&D and assessed a CMP. These findings are supported by the Comptroller's Findings of Fact and Conclusions of Law ("FFCL") set forth in Appendix A, which are incorporated herein.[3] Because these findings establish that it is appropriate to issue a C&D and assess the CMP sought by E&C, an order to that effect is set forth at the conclusion of this decision.

FACTUAL BACKGROUND

A. Keystone's Pre-1998 Securitization Program

In 1992, Keystone radically changed its business plan from that of a small, traditional lender and began growing rapidly through the securitization of high-loan-to-value, second and third mortgage loans. FF 83. Initially, Keystone's securitization program was conducted as follows: Keystone, through its operating subsidiary, Keystone Mortgage Corporation ("KMC"), would acquire loans from large originators located throughout the country. FF 84. The bank initially used brokered deposits and Federal Home Loan Bank of Pittsburgh ("FHLB-Pittsburgh") advances to fund these acquisitions. FF 84. Keystone would re-underwrite these loans to assure itself that the loans met securitization standards. FF 85.

Keystone used asset servicers to collect the principal, interest and penalties on the loans held prior to the securitization, and the servicers sent Keystone monthly interest income checks on the loans. FF 86. Once it had purchased a sufficient number of loans to execute a securitization, Keystone would establish a trustee to whom the loans would be sold. FF 87. In turn, the trustee would issue and sell securities that represented a proportional beneficial interest

[3] Paragraph numbers for the findings and conclusions in the FFCL are cited as "FF ___ and "CL ___," respectively.

in the loan payments and a proportional ownership interest in the loans in the pool. FF 87. The trustee would compensate Keystone for the loans by delivering to Keystone the cash proceeds from the sale of the securities plus the residual interest in the loan pool. FF 87. Between 1992 and 1997, Keystone's asset size reportedly grew from approximately $100 million to $1 billion. FF 82, 83.

B. Keystone's Arrangement with United

In February 1998, Keystone finalized an arrangement with United National Bank, Wheeling, West Virginia ("United") that significantly changed Keystone's securitization program. Under this arrangement, Keystone began purchasing loans as agent for United, *instead of purchasing loans for securitization as principal for its own account*. FF 89. Keystone would notify United on a daily basis of the loans available for acquisition and United would provide funding for their acquisition. FF 89, 90. Keystone would "re-underwrite" these United loans just as Keystone had done with respect to loans it bought in its own name prior to the United arrangement. FF 90. Asset servicers, retained by Keystone, serviced the loans owned by United up to the time of the next securitization. FF 94. Because United owned the loans, the servicers sent United, not Keystone, monthly checks in connection with the interest income on the loans they were servicing for United. FF 96. In 1998, United acquired approximately $960 million in loans under this arrangement. FF 102. Keystone executed two securitizations (May and September) using approximately $500 million in loans owned by United. FF 103.

C. OCC's Criticism of Keystone's Records and Accounting

Almost from the beginning of Keystone's securitization program, the OCC examiners criticized: (1) Keystone's accounting for its residual interests in the securitizations because of its

impact on Keystone's capital position; (2) the bank's internal controls; (3) the accuracy of the bank's books and records; and (4) the filing of inaccurate quarterly Reports of Condition and Income ("Call Reports"). FF 127. The OCC's 1997 report of examination ("ROE") was particularly critical of the bank, and indicated that supervision of Keystone had been transferred from the district office to the OCC's Special Supervision Division in Washington. FF 128. The OCC's 1997 ROE gave Keystone an unsatisfactory composite CAMELS rating of "3," and an unsatisfactory management rating of "4." FF 129. The OCC required Keystone to file amended Call Reports for the first and second quarters of 1997. FF 130.

In February 1998, the OCC informed Keystone that its Call Report for the third quarter of 1997 was inaccurate and required that they be amended. FF 130. The OCC pointed out that the bank had not addressed many of the accounting and internal controls problems noted in the 1997 ROE. FF 130. On May 8, 1998, the OCC communicated to Keystone that it was considering the imposition of civil money penalties in connection with Keystone's inaccurate 1997 Call Reports.[4] FF 131.

In May 1998, Keystone and the OCC entered into a formal supervisory agreement ("Formal Agreement") related to the accounting and reporting irregularities noted in the OCC's 1997 ROE. FF 132. The Formal Agreement required, among other things, that Keystone correct the accounting and internal control deficiencies noted in the OCC's 1997 ROE and retain a nationally recognized accounting firm to audit the bank. FF 133. Specifically, the Formal Agreement required the national accounting firm be retained "to perform an audit of the Bank's

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[4] In December 1998, Ms. Terry Church, a director and the bank's senior vice president, paid a CMP of $13,000 and other directors paid CMPs of $2,000 each for filing inaccurate Call Reports.

mortgage banking operations and determine the appropriateness of the Bank's accounting for purchased loans and all securitizations." FF 133, 134.

One month after the Formal Agreement was effective, the OCC, in June 1998, informed Keystone that it was "undercapitalized" and, accordingly, Keystone was prohibited from accepting, renewing, or rolling over brokered deposits. FF 135. In addition, the FHLB-Pittsburgh placed the bank's line of credit in "full collateral status," *i.e.*, began requiring physical possession of loans used by Keystone as collateral for FHLB-Pittsburgh borrowings. FF 135. Being "undercapitalized" also meant that Keystone was restricted in terms of asset growth and prohibited from paying dividends. FF 135.

In July 1998, Keystone chose Grant Thornton as its external auditor and Grant Thornton began providing accounting services at that time, even though the audit engagement letter was not finalized until September 1998 and the audit did not begin until late December 1998. FF 136, 137. At the same time that Grant Thornton began providing services to the bank in the summer of 1998, the OCC was in the process of completing its 1998 ROE. FF 137. Grant Thornton was aware that the OCC's 1998 ROE downgraded the bank's composite CAMELS rating from "3" to "4," and downgraded the management rating for the bank from "4" to "5." FF 137, 139, 140, 150.

In early December 1998, Grant Thornton representatives attended a meeting between the OCC and Keystone management to discuss the findings and conclusions of the OCC's 1998 ROE. FF 139. In the presence of Grant Thornton, the OCC examiners stated that Keystone had misstated its assets by about $90 million (almost ten percent of the bank's reported assets) in connection with three separate misstatements. FF 139. In addition, the OCC indicated that Ms.

Terry Church appeared to have deliberately mischaracterized $760 million of the bank's assets in calculating the bank's risk-based capital for call reporting purposes. FF 140.

The misclassification of assets by Ms. Church had the effect of erroneously categorizing Keystone as "well capitalized" under the prompt corrective action standards of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), Pub. L. No. 102-242, 105 Stat. 2236 (1991). FF 140, 141. Because the corrected Call Report showed that Keystone was not "well capitalized," its use of brokered deposits as a funding source was restricted. FF 142. The OCC informed Ms. Church and others at Keystone that it was contemplating assessing new CMPs against them in connection with the findings in the OCC's 1998 ROE.[5] FF 151.

D. Grant Thornton's Audit

GAAS requires that auditors possess appropriate skill and training, maintain an independent mental attitude, and exercise "due professional care." FF 22–28. "Due professional care" requires the auditor to plan and perform the audit in order to obtain *reasonable assurance* that the financial statements are free from material misstatements whether caused by error or fraud.[6] The "due professional care" standard also mandates that auditors be assigned tasks and supervised in a manner consistent with their level of skill and experience. "Due professional care requires the auditor to exercise *professional skepticism*."[7] "Professional skepticism," in turn,

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[5] In July 1999, the OCC assessed a $100,000 CMP against Ms. Church, and $25,000 CMPs against other directors and officers of Keystone. These CMPs were stayed when the OCC closed the bank and appointed the FDIC as receiver.

[6] GAAS is based upon the premise of "reasonable assurance," and an auditor is neither an insurer nor a guarantor. FF 31 (GT Ex. 210 (AU 230.13)).

[7] FF 25 (GT Ex. 210 (AU 230.07) (emphasis original)). "Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence." FF 25. Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism is required throughout the audit

dictates that an auditor not be satisfied with less than persuasive evidence. FF 26. In addition, "professional skepticism" is important in evaluating the results of the third party confirmations, and requires that "significant" confirmations be obtained in writing. FF 73.

As part of the audit planning process, the auditor is required to assess the risk of material misstatements (whether caused by error or fraud). FF 29, 38, 63. In order to properly assess this risk, the auditor is required to obtain a level of knowledge of the entity's business sufficient to enable him or her to understand the events, transactions, and practices that may have a significant effect upon the financial statements. FF 18–21. The auditor's understanding of the internal controls may heighten concern about the possibility of material misstatements, and impact the nature, timing, and extent of tests to be performed. FF 34, 43. As an integral part of the risk-assessment process, the auditor is required to assess the risk of material misstatements in the financial statements due to fraud. FF 47. Higher detection risk[8] requires the auditor to modify or expand procedures, particularly in critically important areas, because the degree of "professional skepticism" required increases as the risk that material misstatements will go undetected increases. FF 32, 36, 41, 59.

In addition to GAAS, Grant Thornton was operating under a settlement order (the "OTS Order") it entered into with the Office of Thrift Supervision ("OTS"), which remained in effect

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process. FF 28 (GT Ex. 210 (AU 230.08)).

[8] "Detection risk is the risk that the auditor will not detect a material misstatement that exists in an assertion." FF 32 (GT 212 (AU 312.12)). "Whenever the auditor has concluded that there is a significant risk of material misstatements of the financial statements, the auditor should consider this conclusion in determining the nature, timing, or extent of procedures; assigning staff; or requiring appropriate levels of supervision." FF 32 (GT 212 (AU 312.17)). "Inherent and control risk differ from detection risk in that they exist independently of the audit of financial statements, whereas detection risk relates to the auditor's procedures and can be changed at his or her discretion." FF 32 (GT 212 (AU 312.28)).

until 2001 and related to accounting services that a predecessor of Grant Thornton performed for San Jacinto Savings Association of Bellaire, Texas.[9] FF 4–7. The OTS Order required Grant Thornton when auditing any insured depository institution to conduct a pre-audit review of the institution's internal controls and assess the risks that the institution's financial statements contained material misstatements. FF 6. In this regard, the OTS Order required that Grant Thornton test Keystone's internal controls for reliability prior to Grant Thornton relying upon tests based upon internally generated bank financial data. FF 6.

In preparing the 1998 audit plan for Keystone, Grant Thornton conducted an environmental risk assessment, as required by GAAS and the OTS Order, to determine what procedures were necessary to carry out the audit. FF 152. Grant Thornton planned the audit of Keystone with knowledge of the following facts that clearly demonstrated heightened audit risk: (1) in a short period of time Keystone had grown rapidly in asset size and profitability (FF 82, 83); (2) Keystone was heavily involved in significant and complex securitizations (FF 82–114); (3) Keystone faced significant liquidity risk (FF 148, 149, 167); (4) Keystone was troubled and undercapitalized (FF 135, 167); (5) Grant Thornton had been retained by Keystone in order to comply with the OCC Formal Agreement that required the bank to retain an external auditor to resolve the bank's accounting inaccuracies and deficiencies and to establish an internal control structure (FF 132–134); (6) the OCC had just downgraded the bank to an unacceptable composite "4" CAMELS rating, and downgraded Keystone's management to the lowest rating of "5" (FF 150); (7) the FBI had investigated Ms. Church with respect to illegal "kickbacks" related

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[9] Grant Thornton consented to this order to resolve a previous enforcement action against Grant Thornton's predecessor firm, *In the Matter of Grant Thornton, LLP, formerly known as Alexander Grant & Company*, OTS Order No. AP 96-30.

to the bank's residential lending (FF 171); (8) Mr. Michael Graham, a vice president of KMC, was cited by the OCC as being responsible for an unexplained $31 million "input error" in the bank's accounting for residual assets (FF 139); (9) Keystone recently had recorded ownership of $44 million in trust accounts even though they were not Keystone assets (FF 139); (10) Keystone also recently had claimed ownership of $16 million in residual interests in securitizations even though Keystone had pledged those interests to other parties (FF 139); (11) the bank had a history of filing inaccurate Call Reports, key insiders had been assessed CMPs in connection with those inaccuracies, and the OCC was considering additional CMPs against these same insiders (FF 151); and (12) the OCC examiners had accused Ms. Church of manipulating Call Reports so that the bank's "well capitalized" status under FDICIA continued to be reported even though inaccurate (FF 140).

Grant Thornton ultimately categorized the Keystone audit as a "maximum" risk audit in accordance with the dictates of its audit manual that purported to carry-out the requirements of GAAS.[10] FF 184, 188. Under the Grant Thornton audit manual, a "maximum" assessment for environmental risk required Grant Thornton to conduct what the manual defined as a "Comprehensive" audit – which called for the highest level of detailed testing of the three audit categories recognized by Grant Thornton. FF 186. Given the facts known by Grant Thornton, this was clearly appropriate and required by GAAS.

Grant Thornton staffed the audit with a lead auditor, Mr. Stanley Quay, and a project manager, Ms. Susan Buenger, neither of whom had any experience with a "Comprehensive"

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[10] GAAS requires auditing firms to provide guidance to its auditors about how to conduct an audit in accordance with GAAS. FF 74.

audit involving a "maximum risk" assessment. FF 188. Ms. Buenger, the auditor assigned to the verification of assets and income related to the bank's securitization program, had little experience with securitizations, and received neither material guidance nor supervision from Mr. Quay, the auditor in charge, or other Grant Thornton personnel. FF 121.

The audit plan called for Grant Thornton to: (1) verify the bank's approximately $500 million in assets reportedly being serviced by third parties by contacting those servicers and requesting written confirmations; and (2) test Keystone's $98 million in reported interest income from loans serviced by third parties for "reasonableness." FF 179. In connection with the verification of asset ownership, Grant Thornton received from Advanta Mortgage Corporation USA ("Advanta") written confirmation that it was servicing $6.3 million in Keystone loans; this figure was substantially and clearly different from the $242 million in assets the bank was reporting.[11] FF 200. Grant Thornton followed up several weeks later with a telephone call and, according to Grant Thornton, was told that there was another pool of Keystone loans in the amount of $236 million. FF 202. Immediately after this call, however, the Advanta representative sent an e-mail to Grant Thornton stating that the pool of $236 million in loans was owned by United. FF 203. Despite this significant discrepancy, Grant Thornton did not request that Advanta reconcile the disparate dollar amounts either orally or, as required by GAAS, in writing, and concluded incorrectly that Advanta was servicing $242 million in Keystone loans

[11] A confirmation letter was also sent to Compu-Link Loans Service, Inc. ("Compu-Link"), because Keystone was reporting that Compu-Link was servicing $227 million in Keystone assets. Compu-Link errantly sent a confirmation letter to Grant Thornton stating that it was servicing $227 million in loans for Keystone, when in fact it was servicing $227 million in United loans that had been acquired by Keystone as agent for United pursuant to the Keystone/United arrangement. FF 200. Compu-Link was only servicing $14 million in loans owned by Keystone. FF 200. Compu-Link became aware of the error during a conference call among Compu-Link, Grant Thornton auditors, and OCC examiners in August 1999, when OCC examiners were in the process of uncovering Keystone's fraud. FF 200.

($6.3 million + $236 million). FF 212. In reality, Advanta was servicing only $6.3 million in Keystone loans as Advanta had stated in its original written confirmation to Grant Thornton.

In connection with the audit of Keystone's reported $98 million in interest income from Keystone loans held for securitization that were serviced by third party asset servicers, Grant Thornton conducted tests that, instead of verifying that the income actually had been received by the bank, merely attempted to demonstrate that the interest income reported was "reasonable" in light of the volume and characteristics of the reported loans. FF 66, 236. These tests were based upon fraudulent financial information with respect to the amount of interest income earned by the bank that Grant Thornton obtained directly from Keystone. FF 236, 237. Keystone overstated its interest income from loans reportedly serviced by asset servicers by almost the entire $98 million. FF 261.

In April 1999, Grant Thornton issued its audit report stating that the audit had been performed in accordance with GAAS and that Grant Thornton had obtained reasonable assurance that the bank's financial statements were free from material misstatements. FF 253. However, in August 1999, the OCC examiners requested and obtained information directly from the servicers (including Advanta), despite efforts by Keystone management to prevent disclosure, showing that Keystone was vastly overstating its assets. FF 256–258. After this information was brought to the attention of Grant Thornton, the auditors conducted another "test of reasonableness" in an attempt to demonstrate that Keystone had received the income reported, but the lead auditor, Mr. Quay, concluded that the analytical test was insufficient as substantive evidence. FF 256. Grant Thornton eventually reviewed actual remittances and bank records (checks and wire transfers) and did not find cash income sufficient to support the volume of loans reported by

Keystone. FF 260. The OCC determined that the bank was hopelessly insolvent and appointed the FDIC as receiver in September 1999. FF 260.

Between the time Grant Thornton issued its audit report in April 1999 and the time the bank was placed in receivership, Keystone paid dividends totaling over $1 million. FF 254. Subsequently, a group of Keystone insiders, including Ms. Church and Mr. Graham, received felony convictions for, among other things, obstruction of the OCC's 1998 bank examination, bank embezzlement, and money laundering. FF 261.

PROCEDURAL BACKGROUND

A. The Enforcement Notices

E&C charged that Grant Thornton recklessly participated in an unsafe or unsound practice that caused more than a minimal financial loss to, or a significant adverse effect on, Keystone when, having determined that the Keystone audit presented maximum risk that errors and irregularities could cause the financial statements to contain material misstatements and that Keystone's internal controls were inadequate to detect material misstatements, it disregarded the requirements of GAAS and the OTS Order in planning and conducting the audit. Specifically, E&C charged that Grant Thornton acted recklessly in verifying the bank's assets when it failed to pursue and resolve the inconsistency between what Grant Thornton believed it was told in a telephone conversation with an Advanta representative regarding Keystone's ownership of loans and a written confirmation and e-mail from Advanta. C&D Notice at 20; CMP Notice at 17–18. E&C also charged that Grant Thornton acted recklessly in using management summaries and reports to confirm income instead of reviewing checks, remittances, wire receipts, or other core financial documents. *Id.* E&C assessed a $300,000 CMP (CMP Notice at 1) and sought a C&D

that, among other things: (1) places restrictions upon Grant Thornton offering non-audit services to financial institutions it audits; (2) limits the number of consecutive years Grant Thornton audit personnel could audit a financial institution; and (3) requires Grant Thornton to document its compliance with GAAS in connection with audits of financial institutions. C&D Notice (Proposed Order).

B. The Administrative Law Judge's Recommended Decision

Following a hearing, the ALJ issued a RD concluding that all statutory elements necessary for Grant Thornton to have acted as an IAP had been established except the requirement that Grant Thornton act "recklessly" in conducting the audit. RD at 6-7, 15, 34. Specifically, the ALJ concluded that, although the "audit was not perfect," Grant Thornton had not acted "recklessly." Accordingly, she recommended dismissal of the charges against Grant Thornton. RD at 15.

C. The Exceptions Filed by the Parties

1. Enforcement Counsel

E&C contends that recklessness must be determined in the context of the relevant standard of care and that, further, GAAS provides that standard. E&C Exceptions ("E&C Exc.") at 14–16. E&C objects to the ALJ's findings and conclusion because the ALJ failed to: (1) discuss or even cite relevant GAAS provisions in connection with the verification of assets reportedly serviced by third party servicers (E&C Exc. at 17); or (2) apply GAAS properly in connection with the audit of reported interest income from such loans. E&C Exc. at 21. Had the ALJ analyzed the evidence in light of what GAAS required under the circumstances, E&C asserts, the ALJ would have concluded that Grant Thornton recklessly participated in the audit of

Keystone and that all statutory requirements for the imposition of a CMP and the issuance of the C&D had been satisfied.

2. Grant Thornton

Grant Thornton challenges the ALJ's findings of fact and conclusions of law with respect to the elements necessary to establish that Grant Thornton acted as an IAP, except those supporting her determination that Grant Thornton did not act "recklessly." Grant Thornton asserts that: (1) the "independent contractor" element of IAP status applies only to individual auditors (GT Exc. at 7–11); (2) planning and conducting the audit did not equate to "participation" in an unsafe or unsound practice (GT Exc. at 11–14); and (3) the audit opinion did not cause financial loss or harm. GT Exc. at 15–19. Grant Thornton's remaining exceptions address the OCC examiners' review of Grant Thornton's workpapers and the fact that the OCC did not disclose to Grant Thornton that the OCC had submitted criminal referrals to the Department of Justice with respect to Keystone management.[12] GT Exc. at 23–28.

DISCUSSION

For the reasons explained below, the Comptroller rejects the ALJ's recommendation of dismissal (RD at 34) and concludes that Grant Thornton acted as an IAP in connection with the Keystone audit. The Comptroller further concludes that the grounds necessary to impose a C&D and assess a CMP have been established. In rendering this decision, the Comptroller has considered Grant Thornton's exceptions and rejects each exception as lacking merit. Grant Thornton's exceptions are either unsupported by the record evidence or unnecessary to the

[12] Pursuant to 12 C.F.R. § 19.40(b), Grant Thornton requested oral argument before the Comptroller on the recommended findings, conclusions, decision, and order of the ALJ.

determination of whether to impose a C&D or assess a CMP. Likewise, E&C filed numerous and lengthy exceptions and to the extent not addressed in this Final Decision, they are rejected.

I. GRANT THORNTON PARTICIPATED IN AN "UNSAFE OR UNSOUND PRACTICE"

The ALJ concluded that Grant Thornton participated in an unsafe or unsound practice by issuing "an unqualified opinion containing materially inaccurate information about the Bank, which can be deemed a practice contrary to accepted banking standards." RD at 6-7. Grant Thornton asserts, in its exceptions, that the ALJ identified the audit itself, rather than the fraud, as the unsafe or unsound practice, and that, in doing so, the ALJ diverged from E&C's assertions in the C&D and CMP notices of charges. GT Exc. at 12. Grant Thornton states that, accordingly, the only question at issue here is whether Grant Thornton's issuance of an erroneous audit opinion constituted "participation" in the fraud of Keystone's management. *Id.*

Grant Thornton is mistaken that E&C asserted only that the material misstatements in the financial statements was an unsafe or unsound practice. E&C's notices charge that Grant Thornton's audit with respect to asset and income verification "violated GAAS and constituted reckless participation in unsafe or unsound banking practices in that . . . [they] facilitated the continued false and fraudulent representation of the Bank's" assets and income. C&D Notice at 20; CMP Notice at 17-18. The notices, therefore, assert that the violation of GAAS in carrying out the audit constituted participation in an unsafe or unsound practice, and this unsafe or unsound practice assisted the bank in continuing its own unsafe and unsound practice (material misstatements about assets and income due to fraud). Clearly, Grant Thornton itself "participated" in an unsafe or unsound practice when it violated GAAS in carrying out its audit.

Grant Thornton cites to several non-banking criminal cases that have interpreted the word "participate" narrowly to require active involvement or affirmative conduct in support of wrongdoing by another. GT Exc. at 12–13. Because Grant Thornton did not know about the fraud being perpetrated by Keystone officers and directors, Grant Thornton argues that it did not "participate" in that fraud within the meaning of 12 U.S.C. § 1813(u)(4). GT Exc. at 11-14. Aside from mischaracterizing the E&C charges, this argument is without merit because its interpretation of the word "participates" would require "knowing" participation. However, 12 U.S.C. § 1813(u)(4) includes as an IAP any auditor that "knowingly or recklessly participates" in an unsafe or unsound practice. Under Grant Thornton's construction "recklessly" would be read out of the definition of an IAP. Grant Thornton acknowledges in its exceptions that its interpretation would cause this result, stating "[d]istorting the term 'participate' to include an *absence* of knowledge about the wrong would turn the word [participate] on its head." GT Exc. at 14 (emphasis original). Plainly, the statute by its terms precludes the interpretation advocated by Grant Thornton.

Moreover, Grant Thornton's interpretation of the word "participates" is contrary to the remedial purpose of 12 U.S.C. §§ 1813(u)(4) and 1818(i)(2)(B). One of the ways that the Financial Institutions Reform, Recovery and Improvement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (1989), strengthened enforcement authority was by explicitly authorizing actions against auditors whose failed audits delayed regulatory action and increased the cost of failed bank resolution. 1989 U.S.C.C.A.N. at 97. Indeed, Grant Thornton's audit failure is the type of audit failure that Congress intended to address in FIRREA. The House Committee on Banking, Finance and Urban Affairs and a task force of its Subcommittee on Financial

Institutions Supervision, Regulation and Insurance held separate hearings that elicited testimony and statements highly critical of independent auditors of failed thrifts, and issued reports citing to two General Accounting Office ("GAO") reports addressing the role of auditors in financial institution failures.[13] Moreover, the Senate Report quoted from one of the GAO reports: "A recent GAO report concluded that, in six of eleven cases studied, 'CPA's did not adequately audit and/or report the S&L's financial or internal control problems in accordance with professional standards.'"[14]

A. GAAS Provided the Standard of Care

FIRREA does not define what constitutes an "unsafe or unsound practice." *Cavallari v. Office of the Comptroller of the Currency*, 57 F.3d 137, 142 (2d Cir. 1995). However, in *Cavallari*, which was an IAP case involving an attorney, the U.S. Court of Appeals for the Second Circuit agreed with the Comptroller that an "unsafe or unsound practice" is conduct deemed contrary to accepted standards of banking operations that might result in abnormal risk or loss to a banking institution or shareholder. *Id.*; *see also Simpson v. OTS*, 29 F.3d 1418 (9th Cir. 1994) (citing *Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990)).

GAAS is designed to assist the auditor in obtaining reasonable assurance that the audited entity's financial statements do not contain material misstatements, and GAAS provides the

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[13] *See* Failure of Independent CPA's to Identify Fraud, Waste and Mismanagement and Assure Accurate Financial Position of Troubled S&L's: Hearing before the Committee on Banking, Finance and Urban Affairs, House of Representatives, 101st Cong. 101-7 (1989) at 213-26, citing GAO, "CPA Audit Quality: Failures of CPA Audits to Identify and Report Significant Savings and Loan Problems" (Feb. 1989); and Adequacy of Examination Levels and Compensation: Hearing before the Examination Audit and Review Task Force of the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Banking Committee, 101st Cong. 101-61 (1989), citing GAO, "Report on Bank Failures: Independent Audits Needed to Strengthen Internal Control and Bank Management" (May 1989).

[14] S. Rep. No. 101-19, at 41 (1989), citing GAO Report on Failures of CPA Audits in the House Hearing, at 215.

standard of care in preparing and conducting audits of insured financial institutions.[15] Indeed, there is no dispute that Grant Thornton was required, as a matter of law, to "meet or exceed the scope and procedures required by" GAAS in connection with its audit report. 12 U.S.C. § 1831m(f)(1).

Although concluding that Grant Thornton had participated in unsafe or unsound practices, the ALJ failed to compare Grant Thornton's conduct to what GAAS demanded under the circumstances of Grant Thornton's audit of Keystone's 1998 financial statements. Accordingly, the Comptroller rejects the ALJ's conclusion that Grant Thornton participated in an unsafe or unsound practice *because* Grant Thornton issued "an unqualified opinion containing materially inaccurate information about the Bank." RD at 6-7. An auditor cannot achieve "absolute assurance that material misstatements in the financial statements will be detected." FF 30. GAAS makes plain that an auditor's opinion "is based on the concept of obtaining reasonable assurance" and an "auditor is not an insurer and his or her report does not constitute a guarantee." FF 31; *see also* FF 29, 30. Had Grant Thornton complied with GAAS, Grant Thornton's issuance of an unqualified audit opinion containing material misstatements would not necessarily have constituted an unsafe or unsound practice. Under the circumstances of this case, however, the Comptroller concludes that Grant Thornton participated in an unsafe or unsound practice because of its numerous and serious violations of GAAS in planning and conducting its audit of Keystone.

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[15] *Accord Potts v. SEC*, 151 F.3d 810, 812-13 (8th Cir. 1998) (finding that GAAP and GAAS "establish[] norms of accounting profession").

B. Grant Thornton's Confirmation of Loans Reportedly Serviced by Advanta Violated GAAS

Keystone asserted that a third party loan servicer, Advanta, was servicing approximately $242 million in loans owned by Keystone. FF 192. Grant Thornton knew that confirmation of this loan balance was material because it represented approximately 25 percent of Keystone's reported assets. FF 194. Grant Thornton also knew that this was a maximum risk audit, and GAAS requires the greatest degree of "professional scrutiny" in such situations. FF 184, 188.

Grant Thornton incorrectly confirmed what Keystone was reporting. As the evidence establishes, Grant Thornton obtained written confirmation that Advanta was servicing only $6.3 million in loans owned by the bank. The ALJ excused Grant Thornton's failure to discover that Advanta was servicing only $6.3 million in loans based upon the ALJ's unsubstantiated belief that bank management must have interfered with Grant Thornton's confirmation efforts with Advanta.[16] RD at 11. Moreover, in reaching this conclusion the ALJ failed to consider what GAAS required of Grant Thornton in the circumstances presented by the Keystone audit. GAAS has detailed standards on planning and conducting an audit in light of identified internal control and fraud risks. FF 38–56. The mere existence of fraud and manipulation in the confirmation process, in and of themselves, therefore, could not relieve an auditor of its obligation to follow GAAS.

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[16] There is no evidence of interference by Keystone management in connection with Grant Thornton's confirmation efforts directed to Advanta. In addition, the Comptroller accords no weight to the ALJ's citation (RD at 11) to a June 2000 errata to Ms. Church's deposition, stating: "UNB [United] owned 100% even though Advanta had confirmed to Susan Binger [sic] that Keystone owned them." OCC Ex. 541 at 000328. The deposition to which this errata pertains is not in the record and, equally as pertinent, the statement is hearsay and lacks any indication as to the time Ms. Church purportedly became aware of what Advanta supposedly told Ms. Buenger.

The fact that Grant Thornton was not retained to perform a "fraud" audit, as the ALJ found, therefore, is irrelevant. GAAS specifically requires *in every audit* that auditors assess the risk that the financial statements may be materially misstated due to fraud. FF 38, 47, 48. Grant Thornton found that this audit presented significant fraud risks and its expert, Mr. Jay Goldman, agreed. FF 166, 169. Although it may be true that auditing procedures may sometimes be ineffective for detecting some intentional misstatements (GT Exc. 210 (AU 230.12)), that does not excuse auditors from following heightened professional skepticism procedures when audit risk is at the maximum. In fact, GAAS requires greater scrutiny in such cases, not less. FF 38, 55, 57–60, 63.

The auditing experts for both parties (Mr. Harry Potter, who testified on behalf of E&C, and Mr. Goldman, who testified on behalf of Grant Thornton) agreed that, because the confirmation of Keystone assets reportedly serviced by third party servicers was "significant," GAAS required that Grant Thornton obtain *written* confirmation from Advanta that it was servicing the $242 million in loans that Keystone was reporting on its balance sheet. FF 70. In order to initiate the confirmation process, Grant Thornton sent a letter at the end of December 1998 to Advanta requesting that Advanta confirm in writing the Keystone loans it was servicing as of December 31, 1998 (the date of significance for purpose of the audit of loans reportedly owned by Keystone). FF 197. Believing that Advanta had failed to respond to Grant Thornton's request for written confirmation, Ms. Buenger, the Grant Thornton project manager assigned to this part of the audit, placed a telephone call in March 1999 to Ms. Patricia Ramirez, an account manager at Advanta, and was told by Ms. Ramirez that in early January 1999 Advanta had responded in writing to Grant Thornton's request for written confirmation. FF 198. Ms.

Buenger then faxed a copy of the confirmation-request letter that Grant Thornton had previously sent to Advanta and asked for another written response. FF 199. Advanta responded by sending Grant Thornton a copy of what had been mailed to Grant Thornton earlier. FF 200. Advanta's written response confirmed that, as of December 31, 1998, Advanta was servicing only $6.3 million in loans owned by Keystone under Investor No. 405 – not $242 million. FF 200.

On April 7, 1999, Ms. Buenger telephoned Ms. Ramirez about the Advanta confirmation. FF 202. Ms. Buenger testified that she asked Ms. Ramirez if there were any more Keystone loans and Ms. Ramirez indicated that Advanta was servicing more loans than had been identified in the written Advanta response. FF 202. Ms. Buenger testified that she then discussed with Ms. Ramirez the best way to get that information in writing and that they decided that Ms. Ramirez would send her an e-mail to that effect. FF 202. Within minutes of this conversation, Ms. Ramirez sent Ms. Buenger an e-mail that unequivocally stated that Advanta was servicing $236 million in loans *owned by United* under Investor No. 406. FF 203.

Contrary to the ALJ's suggestion (RD at 8) that the e-mail "confirmed a $236 million pool" owned by Keystone, the e-mail planly stated that the loans were *owned* by another bank, United. The e-mail did not mention Keystone.[17] FF 203. Ms. Buenger further testified that Ms. Ramirez never mentioned United in this telephone conversation (FF 205) and that she never asked Ms. Ramirez whether Advanta had two pools of Keystone loans. FF 206. Nonetheless, Ms. Buenger stated that she made a notation after the telephone conversation with Ms. Ramirez on a folder flap: "Per discussion with Patricia Ramirez at (619) 674-3876, the loans coded under the "United" name actually belonged to Keystone as of December 31, 1998." FF 214.

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[17] Under the Advanta record system, the "investor" was the owner of the loans.

Ms. Ramirez testified through her deposition that, although she did not recall the telephone conversation, she simply would not have been confused about who owned the loans of Investor No. 406. FF 208, 209. She testified that she recalls sending e-mails to United and Keystone informing them of their respective investor numbers. FF 191. Moreover, she testified that she could not recall an instance when she had been confused about who owned loans in any particular file or an instance when loans were mis-coded. FF 209. She explained that it was her job as the accounts manager to know who owned the loans under any particular investor number. FF 210. Grant Thornton's expert, Mr. Goldman, testifying generally about his experience with third party servicers, confirmed that servicers are sophisticated and that a loan servicer is going to know what information is being sought because they respond to such requests all the time throughout each year. FF 211.

Ms. Buenger did not pursue or resolve with Ms. Ramirez or anyone else at Advanta the inconsistencies raised by this e-mail or the fact that the confirmation response indicated that Keystone owned only $6.3 million in loans. FF 212. Instead, even though the e-mail did not state that $236 million in loans were owned by Keystone, based upon Ms. Buenger's understanding of her telephone conversation with Ms. Ramirez, Ms. Buenger simply added the $236 million from Investor No. 406 (United) to the $6.3 million from Investor No. 405 (Keystone) and concluded that Keystone owned $242 million in loans being serviced by Advanta. FF 213.

According to the testimony of Mr. Potter, even if Ms. Buenger's version of the telephone conversation is credited and the notation on the folder was made contemporaneously with the telephone conversation with Ms. Ramirez, GAAS still required that Grant Thornton obtain

confirmation of Keystone's ownership of the loans in writing because of the significance of the dollar value of the loans in relation to total reported assets. FF 215. He explained that the written information obtained by Grant Thornton from Advanta not only indicated that only $6.3 million in loans was owned by Keystone, but also that $236 million in loans were not owned by Keystone. FF 216. Mr. Goldman, Grant Thornton's expert, agreed, stating that "there is no way that the e-mail in and of itself was a confirmation, because I think we'd all agree that it did not indicate the $242 million of loans that were on the books." Tr. 3113 (Goldman).

Such blind reliance upon an oral communication, contradicted immediately by a written communication, was not only a violation of GAAS's written confirmation requirement, but also constituted a violation of the auditor's responsibility to exercise "professional skepticism" in considering the competency and sufficiency of the evidence. FF 27. Moreover, had Grant Thornton understood the United/Keystone relationship, as required by GAAS, Ms. Buenger would have understood that Keystone and United were sharing information in order to execute the securitizations, and that Investor No. 406 contained United loans destined for future Keystone securitizations. Mr. Potter listed a number of ways in which Ms. Buenger could have requested clarification of the e-mail in writing, including sending a reply e-mail asking Ms. Ramirez to document in writing why loans coded as owned by United were, in fact, owned by Keystone. Tr. 2717 (Potter).

Even though Mr. Goldman agreed with Mr. Potter that GAAS required that the confirmation be in writing, Mr. Goldman testified at the hearing that Ms. Buenger was entitled to rely upon her understanding of the telephone conversation with Ms. Ramirez, because the telephone conversation was not an "oral confirmation." Instead, Mr. Goldman characterized the

telephone conversation as "support for the reconciliation between the written confirmation and what's on their books." Tr. 3109 (Goldman). Mr. Goldman's hearing testimony, however, contradicts his earlier deposition testimony, where he testified, consistent with Mr. Potter's hearing testimony, that the telephone conversation was, in fact, an oral confirmation. Tr. 3109, 3111–3112 (Goldman).

Mr. Goldman also asserted at the hearing that Ms. Buenger was entitled to rely upon Ms. Ramirez's e-mail as evidence that the loans described were owned by Keystone because Advanta had a policy of not sending information about one client to another client. Tr. 3111–3112 (Goldman). However, Mr. Goldman did not identify any applicable GAAS exception to the written-confirmation requirement that would support his assumption, and, moreover, there is no such exception. Further, given the Keystone/United arrangement, Keystone, of necessity, had access to United loan information and Advanta representatives knew that the two banks shared information. FF 207.

Also unpersuasive is the other evidence Grant Thornton offered to bolster the propriety of Ms. Buenger's conduct.[18] Ultimately, even Grant Thornton's expert, Mr. Goldman, acknowledged that in light of the $6.3 million confirmation response from Advanta, none of the evidence cited as supporting the conclusion that Keystone owned all of the $242 million in loans

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[18] Grant Thornton pointed to the following non-confirmation evidence: (1) a one-page forged Compu-Link remittance for December 1998 that was attached to a letter from a Compu-Link senior accountant, Mr. Forrest Krum, stating that "a detailed trial balance" was attached (OCC Ex. 295); (2) a letter from Mr. John LaRose, Compu-Link's chief executive officer, stating that, on December 17, 1998, Compu-Link transferred $242 million in loans to Advanta, as instructed (OCC Ex. 500); (3) a falsified schedule prepared by Keystone management showing Advanta servicing $242 million in Keystone loans (GT Ex. 1D); and (4) a conversation that took place sometime during January or February 1999 in which Keystone's attorney, a Mr. Lambert, made a comment about the transfer of loans from Compu-Link to Advanta (Tr. 2402 (Buenger)). None of this evidence constituted the "sufficient competent evidential material" required by GAAS. (GT Ex. 206 (AU 150.02). *See* note 19, below.

being serviced by Advanta, was sufficient to comply with GAAS's written confirmation requirement because none of it was a response to a request to Advanta for written confirmation. Tr. 3104 (Goldman).[19]

C. Grant Thornton's Audit of Interest Income Reportedly Received in 1998 from Loans Serviced by Others Violated GAAS

For 1998, Keystone reported approximately $98 million of interest income from assets serviced by third parties specializing in servicing loans owned by other financial institutions. FF 218. The audit of this interest income was exceptionally important because it dwarfed any other number on the income statement. FF 218. Because Keystone did not own $236 million of the $242 million in loans the bank claimed were being serviced by Advanta (and did not own the approximately $227 million in loans the bank claimed were being serviced by Compu-Link), Keystone received almost none of the reported $98 million in interest income.

In auditing Keystone's reported interest income, Grant Thornton employed an analytical test, called a "test of reasonableness." FF 179. This test simply compared the reported income to the dollar amount and the characteristics of reported loans in order to determine if the reported income was "reasonable." FF 180. E&C charged that the "test of reasonableness" violated

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[19] This evidence is inadequate for other reasons. The attachment to the Krum letter is a remittance – not "a detailed trial balance" as stated in the accompanying letter. The LaRose letter does not state that Keystone owned the loans that were transferred from Compu-Link to Advanta, all $242 million of these loans ($236 million belonged to United) were acquired in anticipation of a 1998 Keystone securitization (which almost exclusively used loans owned by United), and the transfer took place for reasons related to Keystone's securitization program (Compu-Link lacked the Wall Street rating desired by the Keystone's securitization counsel). Grant Thornton was not permitted by GAAS to rely upon the "lead sheet" prepared by Keystone management because it knew Keystone's internal controls were unreliable and Grant Thornton had not independently verified the data for accuracy. Finally, the conversation with Mr. Lambert obviously was not in writing, did not discuss the number of loans or the dollar value of the loans transferred, and, as was the case with respect to the LaRose letter, had Grant Thornton understood the Keystone/United securitization program, Grant Thornton would not have been misled into believing that all of the transferred loans belonged to Keystone. GT also relied upon an "electronic bulletin board download," but Ms. Buenger did not log onto the system, did not pull up the data observed, the data was not as of December 31, 1998, and she acknowledged that this information was not a confirmation. Tr. 2400–2401 (Buenger).

GAAS because GAAS required a "test of details" under the circumstances. A "test of details" refers to a substantive test that reviews primary financial documents including, but not limited to, remittances, wire transfers and cash receipts. FF 64. Simply put, a "test of details" involves looking at specific transactions whereas an analytical test seeks to compare the relationships of entries to the financial statements themselves. FF 64, 66.

1. GAAS Required a "Test of Details"

The ALJ excused Grant Thornton's failure to conduct a "test of details" because Ms. Buenger had "overall concerns about the [bank's] records." RD at 14. "The problem with a test of details at Keystone was that many documents were fabricated." RD at 14. The fact that an auditor may have concerns about an entity's internal controls and the accuracy of its accounting data, however, does not mean that the auditor can blindly rely upon financial data provided by the very management that has created such concerns. In such circumstances, GAAS requires greater "professional scrutiny" – not less. FF 22–28, 40, 54. When an auditor lacks confidence in the internally generated data, GAAS requires that an auditor independently review primary financial documents such as remittances, wire transfers and cash receipts in order to assure that the entity is actually receiving the reported income. FF 235.

There is no dispute that GAAS, under the circumstances of the Keystone audit, required Grant Thornton to conduct a "Comprehensive" audit, as described in Grant Thornton's audit manual. FF 160. Nevertheless, Grant Thornton performed only analytical tests in auditing interest income for loans serviced by third parties, even though GAAS requires that in a maximum risk audit auditors should primarily rely upon a "test of details" for auditing both the

balance sheet (asset ownership) and the income statement (income on loans serviced by others). FF 160.

In spite of this clear statement of what GAAS required under the circumstances of the Keystone audit, Grant Thornton relied at the hearing upon a qualifying statement in its auditing manual, which purports to follow GAAS, to the effect that an analytical test could be used in place of a "test of details" if the analytical test was "very strong." FF 160. Although the ALJ agreed with Grant Thornton, her conclusion was incorrect because there is no dispute that, for purposes of determining whether Grant Thornton engaged in an unsafe or unsound practice, Grant Thornton's audit manual does not and cannot trump the standard of care set by GAAS. Under GAAS, an analytical test could be used as a substantive test in place of a "test of details" *only* (1) where potential misstatements would not be apparent from an examination of the detailed evidence or (2) where detailed evidence is not readily available. FF 67, 228.

As Mr. Potter testified, in the circumstances of this audit, reliance upon an analytical test (the "test of reasonableness") was inappropriate because neither of the two conditions identified in AU § 329.12 was present.[20] FF 67, 228. With respect to the first condition, the bank's interest income would have been apparent from an examination of the detailed evidence, and, with respect to the second condition, this evidence was readily available. FF 227, 228. Grant Thornton would have had to review only twelve monthly Compu-Link remittances and track the cash into the bank's records, because most of the loans reportedly serviced by third party servicers in 1998 were supposedly serviced by Compu-Link. FF 260. Indeed, in August 1999,

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[20] OCC Ex. 781 (AU 329.12) ("Analytical procedures may be effective and efficient tests for assertions in which potential misstatements would not be apparent from an examination of the detailed evidence or in which detailed evidence is not readily available.").

when the fraud was uncovered, that is precisely what Grant Thornton auditors did in an effort to prove to the OCC examiners that Keystone had, in fact, received the income Grant Thornton's audit purported to verify. FF 258. In less than an hour, Grant Thornton's August 1999 review demonstrated that Keystone had not received the $98 million in reported income because it did not own the loans. FF 226. This is also the same procedure that the lead auditor, Mr. Quay, used during the audit to verify Keystone's correctly reported interest income related to its residual assets. FF 223.

2. The Analytical Test Based Upon Bank Generated Documents and Call Reports Did Not Satisfy GAAS

The ALJ concluded that:

> GAAS and Grant Thornton's manual did not require a test of details. OCC's expert testified that the manual, which complied with GAAS, permitted "very strong" analytical procedures for a maximum risk audit.

RD at 15. The ALJ then found, based on Ms. Buenger's testimony, that the "test of reasonableness" used by Grant Thornton was "very strong" because Grant Thornton had obtained asset confirmations from third party servicers. RD at 15.

As an initial matter, an analytical test for verification of interest income, within the plain terms of Grant Thornton's manual, cannot be "very strong" simply because a "test of details" was performed in the verification of asset ownership. The three types of audit strategies in Grant Thornton's audit manual must be read together. FF 158–160. In an "Analytical" audit, "tests of details" can be minimized or eliminated because environmental factors, accounting systems and control procedures "are sufficiently strong to allow us to accept maximum detection risk." FF 158. A "test of details" in an analytical audit is performed only on those items that warrant

detailed examination. FF 159. A "Basic" audit, the second of the three audit strategies, usually requires analytical procedures to be augmented with "tests of details" only because the internal controls have not been exhaustively tested, although they have been tested sufficiently to believe that they are generally reliable. FF 159. In a maximum risk "Comprehensive" audit, the manual states that, because "environmental factors, accounting systems or control procedures are sufficiently weak to cause the possibility of a material misstatement occurring in the related financial statement account to be high," the auditors are to "concentrate on tests of details for both balance sheet and income statement accounts." FF 160. Under this scheme, if Grant Thornton auditors in the context of a maximum risk "Comprehensive" audit, could dispense with a "test of details" in verifying income just because they had performed a "test of details" in verifying assets on the balance sheet, there would be no meaningful distinction between a "Comprehensive" audit and a "Basic" audit.[21]

Although Grant Thornton's manual states in describing the "Comprehensive" audit strategy that "very strong" analytical procedures may be used to provide "substantive evidence," even though the auditors are instructed to concentrate on "tests of details," Mr. Potter testified that the results of the analytical procedures employed by Grant Thornton did not qualify as "substantive evidence" and the analytical procedures were not "very strong." FF 244. Because Grant Thornton used a "test of reasonableness" that did not provide "substantive evidence" (FF 246), it violated *both* GAAS and its manual. In other words, even assuming, *arguendo*, that

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[21] *Compare* Basic Audit ("This strategy generally emphasizes analytical procedures on income statement accounts and tests of details, on a reduced scope basis, for balance sheet accounts.") and Comprehensive Audit ("[T]his strategy generally concentrates on tests of details for both balance sheet and income statement accounts. If analytical procedures are performed for the purpose of providing substantive evidence, they are generally proof-in-total or other very strong analytical procedures."). OCC. Ex. 327 at GT 012344.

the Grant Thornton manual, and not GAAS, is the standard of adequacy, Grant Thornton's conduct of the audit in this case failed that standard.

The "test of reasonableness" utilized by Grant Thornton was not a substantive test because the financial data upon which it was based was wholly unreliable. FF 232–243. Before an analytical test can provide substantive evidence under GAAS, GAAS requires the auditor to assess the reliability of the data upon which the test depends by considering the following factors: (1) whether the data was obtained from independent sources outside the entity or from sources within the entity; (2) whether sources within the entity were independent of those who are responsible for the amount being audited; (3) whether the data was developed under a reliable system with adequate controls; (4) whether the data was subjected to audit testing in the current or prior year; and (5) whether the expectations were developed using data from a variety of sources. FF 68. All of these factors indicated that the information obtained from Keystone management for the "test of reasonableness" was unreliable. Accordingly, although the ALJ was correct that Mr. Potter testified that in certain circumstances GAAS permitted the use of "very strong" analytical tests to provide substantive evidence (circumstances, as discussed above, not present here) and even assuming that Grant Thornton's audit manual generally fulfilled its obligation to provide guidance to its auditors concerning GAAS compliance, the "test of reasonableness" employed by Grant Thornton was neither substantive nor strong.[22] FF 243–244.

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[22] GAAS provides that the internal controls of the entity being audited must be tested for reliability before an analytical test may be used as substantive evidence. AU 312.16; AU 312.17; AU 326.11, 326.13; AU 319.03, 319.05; *see also* OCC Ex. 296 at GT/F 00529; OCC Ex. 327 at GT 012344 (importance of internal controls systems to analytical tests).

Because, as Grant Thornton was aware, Keystone's internal controls and accounting data were unreliable, both experts agreed that GAAS required that Grant Thornton test for accuracy all financial data provided by Keystone's management. Tr. 2729-30 (Potter); Tr. 3058 (Goldman). Grant Thornton's expert, Mr. Goldman, even testified that "if you are not relying on controls and you ask the client to prepare a schedule, regardless of the circumstances, even if it's a well-controlled bank, you know, the auditor has a responsibility to go back and evaluate it and compare it to the company records." Tr. 3058 (Goldman). Ms. Buenger admitted that Grant Thornton did not test for reliability any of the financial data that management provided her during the interest-income testing phase, including Keystone's schedule prepared by Mr. Graham and the bank's Call Reports. FF 236.

Despite the unreliability of Keystone's internal controls and Grant Thornton's failure to independently verify all financial data provided by Keystone management for use in the analytical test, Ms. Buenger still believed the "test of reasonableness" was "very strong" "because there is a normal correlation between the loan portfolio and the interest income that is earned on a loan portfolio." Tr. 2409 (Buenger). However, as Mr. Potter noted, if the income data used in the "test of reasonableness" has been manipulated, the "normal correlation" will exist only because that is what the manipulator desired – not because it actually exists. FF 229.

3. The Analytical Test Based upon the December 1998 Remittance Deviated from GAAS in Several Respects

Ms. Buenger testified that, because she had concerns about the reliability of the "test of reasonableness" based upon the Graham schedule and the Call Reports, she conducted a second "test of reasonableness" based upon a purported Compu-Link remittance for December 1998.

FF 247. She testified that she obtained the fraudulent December 1998 remittance from an employee of the bank, named Ms. Watkins, but could not remember whether she asked for it specifically to conduct the test or just saw it on a chair in Ms. Watkins's office. FF 246.

The use of the purported December 1998 Compu-Link remittance violated GAAS for several reasons. First, GAAS required that the interest income stated in the purported December 1998 remittance be tracked into the bank's records in order to make sure that the reported monthly income of $10 million was actually received by Keystone. Tr. 2874-76 (Potter). Grant Thornton did not do this.

Second, reliance upon the purported remittance violated GAAS's requirement that auditors maintain appropriate skepticism. The remittance, a one-page document, was attached to a one-line letter from Mr. Krum, a Compu-Link accountant. It stated: "Enclosed please find a detailed trial balance for the month ending December 31, 1998. The payments received in December 1998 have been forwarded to you." FF 247. There is no dispute that a one-page remittance – not "a detailed trial balance" – was attached to the Krum letter. In addition, the remittance was not on Compu-Link letterhead and did not indicate that Compu-Link generated it. FF 252. Ultimately, Ms. Buenger admitted that she never saw the trial balance (which would have been a voluminous document) associated with this letter, and she did not ask Ms. Watkins or anyone else for the trial balance that was supposedly attached. FF 248, 249.

Professional skepticism should have prompted Ms. Buenger to ask the client or Compu-Link why the body of the letter did not match the attachment, why the trial balance was not attached, why the remittance was not on Compu-Link letterhead, or what prompted Compu-Link to send the letter. FF 28. Auditors are not trained to recognize forgeries. FF 30. Nor are they

held liable as an IAP solely because they may fail to uncover a fraud. FF 30. However, in auditing the financial statements of an insured depository institution, they are required, at a minimum, to comply with GAAS. In the circumstances of the Keystone audit, which presented a maximum audit risk, GAAS did not permit Ms. Buenger to accept the Krum letter and purported attachment uncritically at face value. FF 28.

Third, the methodology Ms. Buenger employed for the test does not comport with the obligation of an auditor to obtain "[s]ufficient competent evidential matter . . . through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." FF 16. In performing the "test of reasonableness," Ms. Buenger took the December 1998 interest income figure and annualized it in order to estimate Keystone's total 1998 interest income from loans serviced by third party servicers over the other eleven months of 1998. FF 245. The underlying assumption in using one month's interest income to calculate Keystone's interest income for the year was that Keystone's assets and income over the course of 1998 were approximately the same as they were for December 1998. This assumption would be incorrect, however, in the event Keystone was using *its own* loans for the two securitizations that it executed in 1998, as Grant Thornton's workpapers assumed.

Grant Thornton believed that Keystone used its own loans to execute two large securitizations in 1998 – one in May and one in September. FF 120. Because Grant Thornton believed Keystone was using its own loans in these securitizations (a total of approximately $500 million), Grant Thornton should have expected loan build-ups prior to each securitization and drop-offs in loans owned by Keystone following each securitization. But Ms. Buenger's second

"test of reasonableness" used the purported December 1998 interest income to derive an annualized income for the year, and assumed relatively steady income from a relatively steady asset base for the entire twelve months. This methodology was exactly contrary to Grant Thornton's assumption that Keystone was using its own loans for the securitizations. In short, Grant Thornton's belief that Keystone used its own loans in the two securitizations, totaling approximately $500 million, should have precluded its annualization of income based upon one-month's interest income.

II. GRANT THORNTON "RECKLESSLY" PARTICIPATED IN UNSAFE OR UNSOUND PRACTICES

To hold Grant Thornton accountable as an IAP, it is not enough to establish that Grant Thornton participated in an unsafe or unsound practice. An auditor does not become an IAP, under 12 U.S.C. § 1813(u), simply by failing to comply with the technical requirements of GAAS. The auditor's conduct, in failing to comply with GAAS, must demonstrate something more. As the Second Circuit observed in *Cavallari,* 57 F.3d at 142, in order to be an IAP, Grant Thornton in planning and conducting the audit must have acted "in disregard of, and evidencing conscious indifference to, a known or obvious risk of a substantial harm."

Based upon a review of the entire record, Grant Thornton's conduct demonstrated a disregard of, and evidenced a conscious indifference to, a known or obvious risk of a substantial harm, under *Cavallari.* In the context of an acknowledged maximum risk audit, an auditor acts with disregard of and conscious indifference to a known or obvious risk of substantial harm when the auditor fails to follow GAAS's heightened scrutiny requirements and fails to execute fundamental and important procedures required by GAAS. To ignore those requirements and

procedures in the planning, staffing, and execution of an audit of the most material and significant entries in the financial statements of an insured depository institution under the circumstances of this case constitutes recklessness within the meaning of 12 U.S.C. §§ 1813(u) and 1818(i)(2)(B)(II).[23]

The ALJ concluded that, because Keystone management acted fraudulently, Grant Thornton was not reckless in carrying out the audit. RD at 15. Contrary to the ALJ's reasoning, and as discussed above, the fact that fraud exists and management is intent upon undermining the audit does *not* excuse the failure of auditors to follow GAAS in auditing two of the most significant entries on the financial statements. GAAS requires that, during the planning phase of an audit as well as during the audit itself, auditors evaluate the risks that the financial statements may be misstated whether caused by fraud or error.

With respect to Grant Thornton's verification of Keystone's interest income, the ALJ observed that, although Ms. Buenger did not know that Keystone management was fabricating documents, she did know that there were overall concerns about the bank's records. RD at 14. From this premise, the ALJ concluded that "[b]ecause of this, Buenger was not reckless in relying on third party verification and reasonableness tests, rather than a test of details." RD at 14. However, to conclude (as the ALJ did) that a "test of details" was not required by GAAS because the auditor had concerns about the integrity of management and the bank's accounting records turns GAAS on its head.

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[23] Although Grant Thornton does not except to the ALJ's conclusion that it did not act recklessly in conducting the audit, Grant Thornton argues in its exceptions that the OCC and FDIC examiners' review of the audit workpapers and failure to discover any GAAS irregularities require a conclusion that Grant Thornton was not reckless. GT Ex. at 23-24. However, as Grant Thornton acknowledges, these examiners were not auditors and they were not reviewing Grant Thornton's workpapers for evidence of compliance with GAAS. *Id.* at 23.

Auditors participate in a "public practice" and owe an "obligation of fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors." FF 11.[24]

A. Grant Thornton "Recklessly" Failed to Comply with GAAS by Not Conducting a Comprehensive Audit with a Test of Details

Although Grant Thornton claims that it planned and conducted a "Comprehensive" audit consistent with its conclusion that the Keystone audit presented maximum audit risk, a review of the entire record demonstrates that Grant Thornton, instead, appears to have planned and conducted a "Basic" audit in violation of GAAS. Tr. 2751-52 (Potter). If Grant Thornton had planned for and conducted a "Comprehensive" or maximum risk audit, it would have relied primarily upon a "test of details" for auditing the interest income of assets reportedly serviced by others and properly obtained *written* confirmation when conducting the "test of details" for auditing the assets themselves. This would have been consistent with GAAS. Use of these procedures would have significantly increased the likelihood that the audit would have detected the true condition of the bank.

Grant Thornton prepared an audit plan for Keystone that called for only an analytical procedure (a "test of reasonableness") with respect to interest income, instead of a "test of details." Nearly all of Grant Thornton's audits were "Basic" audits and the "test of

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[24] Grant Thornton urges the Comptroller to reject the ALJ's finding that the OCC could not disclose non-public information relevant to audit risk, such as criminal referrals of bank management and to "rule that the OCC should have shared with Grant Thornton information regarding management integrity issues." GT Exc. at 24-27; RD at 22, ¶ 41. However, contrary to Grant Thornton's urging, the Comptroller adopts this finding of the ALJ, because, as the ALJ found, the OCC shares adverse information through its ROEs, which Grant Thornton reviewed. Through this vehicle, Grant Thornton was well aware that the OCC had serious concerns about the integrity of Keystone management. And, indeed, Grant Thornton concluded that this was a maximum risk audit.

reasonableness" was the "standard format" used by Grant Thornton. FF 183. In fact, Ms. Buenger always used the "test of reasonableness" to test interest income. FF 183.

By the time Mr. Quay signed off on the audit plan in mid-January 1999 (FF 184), however, Grant Thornton had identified the Keystone audit as presenting "maximum" risk that required a "Comprehensive" audit. FF 184, 185. Despite the "maximum" risk assessment, the audit plan itself was never altered, and Grant Thornton conducted a "Basic" audit. Grant Thornton's failure to conduct a maximum risk audit as required by GAAS in the maximum risk environment Grant Thornton knew to exist evidenced disregard of a known or obvious risk of substantial harm to the users of Grant Thornton's audit reports, or a conscious indifference to that risk.

B. Under the Circumstances, Grant Thornton "Recklessly" Relied upon a Conversation with an Advanta Representative

Grant Thornton acted recklessly in violating GAAS by failing to obtain written confirmation of the assets owned by Keystone and serviced by Advanta. In a maximum risk audit, relying upon an oral confirmation to verify ownership of approximately 25 percent of an entity's reported assets evidenced a disregard of a known or obvious risk of a substantial harm, or evidenced a conscious indifference to that risk. *Cavallari*, 57 F.3d at 142. The quantitative materiality of $242 million is the very reason why GAAS requires the confirmation to be in writing.

Under the circumstances of this audit, however, Grant Thornton's actions were particularly egregious and reckless. Here, Grant Thornton relied upon oral evidence even though it had received unequivocal, written evidence – in the form of a formal written response to a confirmation request – that Advanta was servicing only a small fraction ($6.3 million) of the

$242 million in loans Keystone was reporting. Moreover, the oral evidence concerning the servicing of additional Keystone loans was unambiguously contradicted almost immediately by Grant Thornton's later receipt of an e-mail from Advanta. These two written sources of evidence not only failed to confirm what Keystone was reporting, they also flatly evidenced that Keystone did *not* own nearly all of the loans it was reporting. Nevertheless, in violation of GAAS, Grant Thornton opted to rely upon the oral communication. Reliance upon Ms. Buenger's understanding of an oral communication (even if fully credited) demonstrated a disregard of, or conscious indifference to, the known or obvious risk of a substantial harm that could result to those who relied to their detriment upon assertions in Keystone's financial statements concerning the assets owned by the bank.

C. Grant Thornton "Recklessly" Failed to Comply With GAAS When It Used Analytical Procedures to Test Interest Income

Grant Thornton's use of an analytical "test of reasonableness" for income was reckless because it violated GAAS under circumstances in which Grant Thornton knew that Keystone's internal controls were unreliable and that it could not rely upon internally generated accounting data. Despite this, Grant Thornton recklessly relied on that data without testing Keystone's internal controls or independently verifying the data obtained from Keystone management in total disregard of the risks its actions posed. *Cavallari*, 57 F.3d at 142.

Grant Thornton's conduct, however, evidences even greater recklessness. Not only did Grant Thornton fail to check the accuracy of the data on the Graham schedule, but it also used data from the schedule in its "test of reasonableness" on interest income even though it was aware that at least some of the data in the schedule was inaccurate. Even if Grant Thornton did not know that the precise data points from the schedule that it used were inaccurate, it knew that

the schedule, in fact, contained erroneous data. FF 237. As Ms. Buenger acknowledged, if the data in the schedule was incorrect, the test results would be unreliable. FF 242. Grant Thornton's actions demonstrated a disregard of, or conscious indifference to, the known or obvious risk of a substantial harm that could result from its failure to follow GAAS.

D. Grant Thornton Recklessly Ignored Its Obligation To Understand Keystone's Securitization Process

Grant Thornton's audit manual well summarized GAAS when it stated that "[k]nowledge of the client's business is critical to our overall client relationship and is a key element of our planning procedures. Knowledge of the client's business . . . is key to the determination of critical transaction cycles and assertions." FF 116. Grant Thornton's audit manual addresses GAAS's requirement that the auditor:

> obtain a level of knowledge of the entity's business that will enable him to plan and perform his audit in accordance with generally accepted auditing standards. That level of knowledge should enable him to obtain an understanding of the events, transactions, and practices that, in his judgment, may have a significant effect on the financial statements.

FF 19. This obligation was critical and key because an understanding of a client's principal operating characteristics increases the auditor's ability to identify material misstatements in the financial statements. Grant Thornton's conduct in connection with the use of the December 1998 remittance attached to the Krum letter for verifying interest income and its failure to obtain written confirmation of the Keystone assets serviced by Advanta demonstrates Grant Thornton's reckless indifference to this obligation as it related to Keystone's securitization business.

Despite the importance of understanding the operational characteristics of Keystone's securitization process, Ms. Buenger testified that she did not believe it was important for her to

understand Keystone's securitizations because "that was Mr. Quay's responsibility." FF 125. Ms. Buenger further testified that she was not even aware of the relative size of Keystone's two 1998 securitizations and, in fact, did not know the source of $500 million in securitized loans. FF 125. This testimony is especially remarkable given that Grant Thornton prepared a memorandum prior to the audit describing its (incorrect) understanding that Keystone owned the loans it was transferring to securitization trustees at the time of each securitization. FF 122. Mr. Quay, as the lead auditor, had an obligation under GAAS to supervise Ms. Buenger and to make her aware of the importance of Keystone's securitization process to her audit responsibilities, even if Ms. Buenger, herself, did not think it was important. FF 24. Grant Thornton's disregard of the importance of Keystone's securitization program to the verification of Keystone's reported interest income from loans serviced by servicers demonstrated a violation of GAAS and a disregard of, or conscious indifference to, the known or obvious risk of a substantial harm that could result to those who relied to their detriment upon assertions in Keystone's financial statements.

III. GRANT THORNTON ACTED AS AN "INDEPENDENT CONTRACTOR"

Grant Thornton excepts to the ALJ's conclusion that Grant Thornton, as a firm, can be an "independent contractor" within the meaning of the statute defining an IAP. GT Exc. 7–11; *see* 12 U.S.C. § 1813(u)(4). Grant Thornton contends that the term encompasses only individuals, not firms. The ALJ, however, properly found that the term – "any independent contractor" – unambiguously applies to both firms and entities. The Comptroller agrees with the conclusion of the ALJ. In addition, the interpretation of the ALJ is supported by the circumstances of this case and relevant legislative history. Indeed, according to the FIRREA Conference Report, Congress

intended that "the new term [IAP] . . . broaden[] the group of individuals *and entities* covered." Conf. Rep. No. 101-222 at 439 (emphasis added).

IV. THE AUDIT FAILURE CAUSED "MORE THAN A MINIMAL FINANCIAL LOSS"

The ALJ concluded that Grant Thornton's audit opinion helped Keystone to remain open and to incur additional losses. RD at 7. Further, the ALJ concluded that the audit opinion facilitated the payment of over $1 million in dividends that was made after the opinion was issued, and that the dividend payments caused more than a minimal financial loss to, and had a significant adverse effect upon, Keystone. RD at 7. Finally, the ALJ rejected Grant Thornton's argument that because Keystone's residual assets increased in value between the time the opinion was issued and the time the bank was closed Keystone was not harmed. RD at 7.

In its exceptions, Grant Thornton argues that once a corporation reaches the point of insolvency, the corporation cannot suffer any additional losses. GT Exc. at 15-16. The Comptroller disagrees. At the point of insolvency (which the parties agree was no later than 1996) the creditors and the FDIC deposit insurance fund have an economic interest in the value of the corporation, and, accordingly, management owes a duty to them not to aggravate the entity's insolvency. *See Pereira v. Farace*, 413 F.3d 330, 342 (2nd Cir. 2005), *cert. denied*, 126 S. Ct. 2286 (2006). Accordingly, by facilitating the payment of over $1 million in dividends to shareholders – who at the point of insolvency ceased to have an economic stake in the corporation – Grant Thornton harmed the bank's creditors and the FDIC because it deepened the bank's insolvency.

Grant Thornton also argues that E&C failed to prove that the audit opinion "caused" more than a minimal financial loss to, or a significant adverse effect upon, the bank. GT Exc. at 19-20.

Again, the Comptroller disagrees. Grant Thornton's unsafe or unsound audit was the proximate cause of the loss the bank suffered due to the dividend payments. An auditor cannot avoid responsibility as an IAP by arguing that it is the financial institution's actions that are the "cause" of the loss. First, 12 U.S.C. § 1813(u)(4) covers conduct that "caused or is likely to cause" more than minimal financial loss, or a significant adverse effect on, the bank. Even if the word "caused" could be limited as Grant Thornton argues, Grant Thornton's conduct still would be "likely to cause" more than a minimal financial loss to the bank, because GAAS is designed to protect users of audited financial statements increasing the likelihood that auditors will identify material misstatements whether caused by error or fraud. Tr. 2725 ("following GAAS would have uncovered the fraud at Keystone"), 2927 (Potter).

Under the circumstances of this case, had Grant Thornton followed GAAS, it probably would not have issued the unqualified opinion. This is established by how quickly the true financial condition of the bank was uncovered when the proper procedures were followed. Second, under Grant Thornton's theory, conduct of independent contractors could never be a cause of a loss or other adverse effect for purposes of 12 U.S.C. § 1813(u)(4), because it would always be the financial institution's acts or omissions that led to the loss to, or adverse effect on, the bank. Such a result would defeat the intent of Congress in extending enforcement authority to auditors of insured financial institutions.[25]

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[25] *See* Discussion, Subpart I, above.

V. STANDARDS AND BASES FOR THE ADMINISTRATIVE ACTIONS

A. Action for Civil Money Penalty

The Comptroller finds that the CMP of $300,000 that the OCC assessed against Grant Thornton is justified pursuant to 12 U.S.C. § 1818(i)(2)(B). The OCC assessed this second tier CMP, finding that Grant Thornton's conduct more than satisfied the statutory requirements that: (1) the IAP must have violated any law, regulation or final cease and desist order *or* recklessly engaged in an unsafe or unsound practice in conducting the affairs of the insured depository institution *or* breached a fiduciary duty; and (2) the violation, practice or breach was part of a pattern of misconduct *or* caused or was likely to cause more than a minimal loss to such depository institution *or* resulted in pecuniary gain or benefit to such party. Based on the record and findings that Grant Thornton is an IAP, it is clear that Grant Thornton satisfies each element for imposition of a second tier CMP.

In determining the appropriate amount of a CMP, the Comptroller is required to consider certain factors specified in 12 U.S.C. § 1818(i)(G). Specifically, the OCC must consider "(i) the size of the financial resources and good faith of the insured depository institution or other person charged; (ii) the gravity of the violation; (iii) the history of prior violations; and (iv) such other matters as justice may require." 12 U.S.C. § 1818(i)(G). The Comptroller's decision above, which includes the Findings of Fact and Conclusions of Law contained in Appendix A, establish the appropriateness of the second tier $300,000 CMP.

Although specific evidence of Grant Thornton's net worth is not reflected in the record, the evidence establishes that Grant Thornton, a national accounting firm, is the fifth largest accounting firm in the United States, with three hundred partners, 3,500 employees, and 40

offices. Moreover, Grant Thornton received over $500,000 in fees (including $150,000 for its audit of Keystone's 1998 financial statements) in connection with its Keystone engagement. Accordingly, the Comptroller concludes that Grant Thornton has sufficient resources to pay a $300,000 CMP.

With respect to mitigation where the respondent has acted in "good faith," Grant Thornton's disregard of, or conscious indifference to, the known or obvious risk of the substantial harm that could result to the bank and those who relied to their detriment upon assertions in Keystone's financial statements precludes mitigation on this basis, particularly in light of its disregard of the OTS Order.

In considering the gravity of the offence, the Comptroller has considered evidence establishing that Grant Thornton repeatedly deviated from GAAS in planning and conducting the audit of Keystone's assets and income. Although the Comptroller recognizes that the fraud perpetrated by Keystone officers and directors played a role in the ultimate failure of the bank, Grant Thornton's unqualified audit opinion, stating that Grant Thornton had obtained reasonable assurance that the bank's 1998 financial statements were not materially misstated and were prepared in accordance with GAAP and audited in accordance with GAAS, enabled the bank to remain in business and incur additional losses, including the payment of approximately $1 million in dividends, thereby deepening the bank's insolvency. Accordingly, under the circumstances of the audit, Grant Thornton's laxity in planning and conducting its audit of Keystone was egregious.

The Comptroller has also considered Grant Thornton's history of prior violations. The Comptroller notes that at the time that Grant Thornton planned and conducted its audit of

Keystone it was operating under the terms of the OTS Order. The OTS had initiated its enforcement action to address, among other matters, the failure of Grant Thornton's predecessor to follow GAAS in conducting its audit of an insured depository institution that suffered large losses and was closed. The fact that Grant Thornton was under a regulatory order imposing specific requirements on its audits of insured depository institutions, including the requirement to follow GAAS, when it audited Keystone is significant evidence that supports the imposition of the CMP sought by the OCC. Indeed, Grant Thornton's failure to follow scrupulously the dictates of what GAAS and the OTS Order required in planning and conducting its audit of Keystone is remarkable.[26] Accordingly, considering all relevant factors, including the gravity of Grant Thornton's offence, financial ability to pay the assessment, and previous violations, the Comptroller orders Grant Thornton to pay a $300,000 CMP.

B. Cease and Desist Action

Section 1818(b)(1) of title 12 provides, in pertinent part, that the appropriate Federal banking agency may issue a C&D against an IAP who engaged in an unsafe or unsound practice or who has violated a law, rule or regulation. For the reasons discussed above and established in the record, Grant Thornton is an IAP. The findings above that Grant Thornton participated in an unsafe or unsound practice also establishes the basis for issuing a C&D. The Comptroller, therefore, in a separate Order, imposes a C&D on Grant Thornton addressing Grant Thornton's provision of audit and accounting services to insured depository institutions for six years from the effective date of that Order.

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[26] The OTS Order was in effect until 2001 and required Grant Thornton in connection with the planning of any audit of an insured financial institution to test "internal controls for the purpose of determining the nature, timing, and extent of substantive tests to be performed." FF 5–7.

VI. OTHER MATTERS PENDING BEFORE THE COMPTROLLER

With respect to Grant Thornton's motion for oral argument before the Comptroller, the arguments in support of its motion are unpersuasive, and, accordingly, the motion is denied.

ORDER

Based upon the entire record of the proceeding, the pleadings, the ALJ's RD, Exceptions to the RD filed by both Grant Thornton and E&C, and for the reasons set forth in the accompanying decision, the Comptroller, pursuant to his authority under 12 U.S.C. § 1818, orders Grant Thornton to pay a civil money penalty in the amount of $300,000 and imposes a Cease and Desist Order that will be issued separately.

Respondent's request for an in-person hearing is denied.

IT IS SO ORDERED, this 7th day of December, 2006.

JOHN C. DUGAN
COMPTROLLER OF THE CURRENCY