NO ORAL ARGUMENT DATE HAS BEEN SET

No. 07-1003

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

GRANT THORNTON LLP,

Petitioner,
v.

OFFICE OF THE COMPTROLLER OF THE CURRENCY,

Respondent.

Petition for Review of a Final Decision and Orders of the Comptroller of the Currency Issued in Adjudicatory Proceeding Nos. AA-EC-04-02 and AA-EC-04-03 on December 7, 2006

PROOF BRIEF FOR RESPONDENT

Respectfully submitted,
JULIE L. WILLIAMS
First Senior Deputy Comptroller
and Chief Counsel
DANIEL P. STIPANO
Deputy Chief Counsel
HORACE G. SNEED
Director of Litigation
ELLEN M. WARWICK
Assistant Director of Litigation
JEROME A. MADDEN
Counsel
Attorneys for the Office of the
Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219
Telephone: (202) 874-5280

July 25, 2007

CERTIFICATE OF THE PARTIES, RULINGS, AND RELATED CASES

(A) Parties

Except for the following, all parties, intervenors, and amici appearing before the Administrative Law Judge, the Comptroller of the Currency, and in this Court are listed in the Brief for Petitioner: Office of the Comptroller of the Currency, which is an agency within the U.S. Department of the Treasury.

(B) Rulings under Review

References to the rulings at issue appear in the Brief for Petitioner.

(C) Related Cases

A case involving similar factual issues is pending in the U.S. District Court for the District of West Virginia, *FDIC v. Grant Thornton, LLP*, Civil Action Nos. 1:00-0655, 1:03-2129, 1:04-0043.

JEROME A. MADDEN
Counsel of Record for Respondent

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GLOSSARY

Advanta Advanta Mortgage Corporation USA was an asset servicer that collected mortgage payments and penalties on real estate loans owned by others and sent remittances to the owners on a monthly basis. FF 107, 110, 113. Advanta sent a written response to Grant Thornton's request for confirmation of Keystone assets that stated it was servicing $6.3 million in Keystone loans (FF 201) – not $242 million as Keystone was reporting. It also sent Grant Thornton an e-mail stating that it was servicing $236 million in loans for United. FF 203.

ALJ Administrative Law Judge Ann Z. Cook

Analytical Audit *See* Audit Manual, below.

AU The American Institute of Certified Public Accountants' ("AICPA") statements on auditing standards. FF 12, 13.

Audit Manual GAAS requires that auditing firms provide guidance to their auditors in order to assist them in complying with GAAS. Grant Thornton fulfilled this obligation through its audit manual. Grant Thornton's audit manual described three categories of audits (called the ABC Audit Matrix) depending upon the pre-audit risk assessment (OCC Ex. 327 at GT 012342):

(1) **Analytical Audit**

The first of three types of audits described in Grant Thornton's audit manual and used where the risk of material misstatements was assessed at its lowest level (FF 158, 161–162):

> "The analytical approach minimizes tests of details on the assumption that environmental factors, the accounting system and control procedures are

> sufficiently strong to allow us to accept maximum detection risk. Therefore, this strategy concentrates on scanning, inquiry, and analysis . . . of account balances or transactions so that tests of details, if any, are performed only on those items that warrant a detailed examination. The analytical approach places significant emphasis on understanding and testing of the client's internal control systems." OCC Ex. 327 at GT 012344.

(2) **Basic Audit**

The second of three types of audits described in Grant Thornton's audit manual and used where the risk of material misstatements was assessed as intermediate (FF 159, 161–162):

> "The basic approach generally requires analytical procedures to be augmented with tests of details because we will have minimized the tests of controls that could otherwise result in a lower assessment of control risk. This strategy generally emphasizes analytical procedures on income statement accounts and tests of details, on a reduced scope basis, for balance sheet accounts."
> OCC Ex. 327 at GT 012344.

(3) **Comprehensive Audit**

The third of three types of audits described in Grant Thornton's audit manual and used where the risk of material misstatements was assessed at the highest level, *i.e.*, the "maximum (FF 160–162):"

> "The comprehensive approach relies primarily upon tests of details because . . . environmental factors, accounting system or control procedures are sufficiently weak to cause the possibility of a material misstatement occurring in the related financial statement account to be high. . . Therefore, this 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.

Basic Audit *See* Audit Manual, above.

Brokered Deposits Deposits acquired by an insured depository institution through deposit brokers. Institutions that are not "well capitalized" may not accept funds obtained, directly or indirectly, by or through any deposit broker for deposit into 1 or more deposit accounts.

Call Reports Reports of Condition and Income that are filed quarterly by banks pursuant to 12 U.S.C. §§ 161, 1817(a)(3).

CAMELS A supervisory rating system used by OCC bank examiners to assess a bank's condition from 1 (best) to 5 (worst) where "C" stands for "capital," "A" stands for "assets," "M" stands for "management," "E" stands for "earnings," "L" stands for "liquidity," and "S" stands for "sensitivity" to market risk. Tr. 74 (Schneck).

C&D Order Cease-and-Desist Order issued by the Comptroller on December 7, 2006

CMP Civil Money Penalty

Comprehensive Audit *See* Audit Manual, above.

Comptroller Comptroller of the Currency

Controlling Officer Senior Vice President, Terry Church, who functioned as the Keystone's President. FF 131, 142, 144.

Decision Final Decision issued by the Comptroller on December 7, 2006

Due Professional Care The third of three general GAAS field work standards providing that "due professional care" is to be exercised in the performance of the audit and the preparation of the report by each auditor within the audit organization. FF 22. The "due professional care" standard also mandates that auditors are assigned tasks and supervised in a manner consistent with their level of skill and experience so that the auditor is capable of evaluating the audit evidence. FF 24. "The knowledge, skill, and ability of personnel assigned significant engagement responsibilities should be commensurate with the auditor's assessment of the level of risk for the engagement." FF 24. Due professional care requires the auditor to exercise ***professional skepticism***. FF 25.

"***Professional skepticism***" requires that an auditor have a "questioning mind" in assessing the audit evidence. FF 25. "Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence." FF 27. "Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process." FF 27. Grant Thornton's audit manual echoed the principles in AU 230. "We must maintain an attitude of appropriate skepticism in obtaining audit evidence. Accordingly, when applying procedures to the client's records, schedules and supporting data, we should be on guard to avoid accepting documents and explanations at face value." FF 28. This principle requires that an auditor employ a "show me" attitude. FF 28.

E-Mail The e-mail sent by Patricia Ramirez, the manager of Advanta's investment reporting department, to the Project Manager

	immediately after the two spoke on the telephone on April 7, 1999. FF 203.
FD	FD refers to the Decision. FD ___ is a citation to a particular page(s) in the Decision.
FDIA	Federal Deposit Insurance Act, 12 U.S.C. § 1818
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (1991)
FF	Factual findings of the Comptroller incorporated by reference into the Decision. FF ___ is a citation to particular paragraph(s) in the findings of fact. FD 4.
FHLB-Pittsburgh	Federal Home Loan Bank of Pittsburgh
FIRREA	Financial Institution Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989)
Formal Agreement	Formal supervisory agreement, dated May 1998, between the OCC and Keystone. FF 132.
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Accounting Standards
Goldman (Jay)	Grant Thornton's audit expert
Graham Schedule	A unverified schedule of assets and income prepared at the request of the Project Manager by Michael Graham, a vice president of Keystone Mortgage Corporation, a Keystone subsidiary. FF 236–237.
Grant Thornton	Grant Thornton LLP

House Report	H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1
IAP	Institution-Affiliated Party, 12 U.S.C. § 1813(u)
JA	Joint Appendix
Keystone	First National Bank of Keystone
Lead Auditor	Stanley Quay was the on-site Grant Thornton auditor in charge of the Keystone audit. FF 117.
Maximum Risk	GAAS requires that auditors assess the risk that the financial statements are materially misstated and requires that as the risk increases the auditor perform tests requiring decreased reliance upon the entity's internally generated data or data provided by management. Grant Thornton used the phrase "maximum" to identify a pre-audit assessment of the highest risk of material misstatements. FF 180.
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
OTS Order	On October 3, 1996, Grant Thornton agreed to settle a cease and desist order with the OTS in connection with the provision of accounting and auditing services by Grant Thornton's predecessor to San Jacinto Savings Association, Bellaire, Texas. FF 5. At the time that Grant Thornton planned and conducted its audit of Keystone, it was operating under the terms of the OTS Order. FF 7.
PCA	The "prompt corrective action" requirements set forth in 12 U.S.C. § 1831o that are designed to resolve problems of insured depository institutions at the least possible long-term cost to the deposit insurance fund. 12 U.S.C. § 1831o(a). The degree of supervision required under the PCA standards depend, in part, upon the capital status of the institution. There

are five categories: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” 12 U.S.C. § 1831o(b)(1). As relevant here, institutions that were not “well capitalized,” were not permitted to attract “brokered deposits” in order to fund their activities.

Potter (Harry) OCC’s audit expert

Professional Skepticism *See* Due Professional Care, above.

Project Manager Susan Buenger was the Grant Thornton auditor assigned the responsibility of verifying the assets and interest income Keystone was reporting from assets serviced by third-parties, including Advanta. FF 121, 192, 198, 237.

ROE OCC Report of Examination

SEC U.S. Securities and Exchange Commission

Test of Details A substantive test under GAAS that reviews primary financial documents such as, but not limited to, remittances and cash receipts, and traces those items into bank records, *i.e.*, a “test of details” “goes to the heart” of the interest income transactions with third-party servicers. FF 64.

Test of Reasonableness A simple analytical procedure conducted by the Projec Manager that compared asset volume and loan characteristics to reported interest income to see if the relationship between the two looked “reasonable.” FF 180.

Tr. Transcript of hearing

United United National Bank, Wheeling, West Virginia

Well Capitalized The highest capital category in FDICIA's prompt corrective action capital standards, 12 U.S.C. § 1831o. Absent being categorized as "well capitalized," Keystone's use of brokered deposits as a source for funding the acquisition of assets destined for its securitization business was restricted. 12 U.S.C. § 1831f(a). *See* Brokered Deposits and PCA, above.

COUNTER-STATEMENT OF THE ISSUES

I. Whether the Comptroller of the Currency (the "Comptroller") correctly concluded, based upon substantial evidence in the record, that Grant Thornton LLP ("Grant Thornton") acted as an institution-affiliated party ("IAP"), within the meaning of 12 U.S.C. § 1813(u)(4), in connection with its audit of the First National Bank of Keystone's ("Keystone") 1998 financial statements.

II. Whether the Comptroller, as a proper exercise of his discretion and based upon substantial evidence in the record, properly issued a cease-and-desist order ("C&D Order"), pursuant to 12 U.S.C. § 1818(b), and imposed a civil money penalty ("CMP"), pursuant to 12 U.S.C. § 1818(i)(2)(B)(II), against Grant Thornton as an IAP for its reckless participation in unsafe and unsound practices in auditing Keystone's 1998 financial statements.

INTRODUCTION

This is a case where the conduct of an audit for an insured depository institution departs so far from the standards required by generally accepted accounting standards ("GAAS") that it becomes evident that the audit was conducted in disregard of a known or obvious risk of substantial harm to those who might rely on the auditor's opinion. Specifically, in 1999, Grant Thornton issued a unqualified opinion stating that it had obtained reasonable assurance that

Keystone's financial statements for calendar year 1998 were not materially misstated and were prepared in accordance with generally accepted accounting standards principles ("GAAP"). However, the reality was that Grant Thornton recklessly failed to follow GAAS in the context of a maximum risk audit, notwithstanding the presence of obvious and known risks, and Keystone's financial statements were misstated by hundreds of millions of dollars.

As noted in the Comptroller's decision, the OCC had cited Keystone for years for a number of issues, including inaccurate financial reports, and the agency required the bank to file amended reports in 1997. In 1998, the agency took a formal enforcement action against the bank that required, among other provisions, that Keystone hire a nationally recognized accounting firm to audit the bank.

After Grant Thornton was hired, the firm was made aware of a number of OCC concerns, including the bank's misstatement of its assets by $90 million, or almost 10% of total assets. Although Grant Thornton knew it was conducting a maximum risk audit, the firm did not take the necessary steps to confirm the accuracy of the bank's financial statements and failed to discover that the bank did not own over $230 million in loans it was reporting and failed to conduct tests that would have shown that the largest item on the bank's income statement – $98 million in interest income from loans serviced by third parties – did not exist.

Several months after Grant Thornton issued its unqualified audit opinion, the OCC discovered the bank was hopelessly insolvent and in September 1999 appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver. But not before the bank, relying on Grant Thornton's audit, paid out $1 million in dividends to shareholders – money that should have been made available to the FDIC to help pay for the bank's resolution.

COUNTER-STATEMENT OF THE CASE

An auditor becomes liable for sanctions as an IAP where the auditor's acts or omissions in connection with its audit of an insured depository institution demonstrate recklessness: a disregard of a known or obvious risk of substantial harm to those who are entitled to rely upon the auditor's opinion (including the institution's creditors, the primary federal regulator, and the FDIC). As the Comptroller recognized, an auditor does ***not*** become subject to sanctions simply by failing to comply with the technical requirements of GAAS or failing to detect fraud or misstatement. But where an auditor fails to execute simple and straightforward procedures required by GAAS concerning the most material entries on an insured depository institution's financial statements in the face of circumstances where it knows that the audit presents maximum risk that the financial statements are materially misstated, the auditor is reckless and sanctions under the banking laws are authorized. This is such a case.

The Office of the Comptroller of the Currency (the "OCC"), a bureau of the United States Department of the Treasury, charters and is the primary federal supervisor of national banks and federally licensed branches of foreign banks in the United States. 12 U.S.C. § 1, *et seq*. The OCC is authorized to take supervisory actions against national banks and their IAPs under section 8 of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1818.

Under 12 U.S.C. § 1813(u)(4), as relevant here, an IAP means an independent contractor who: (1) participates in an unsafe or unsound practice which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, an insured depository institution; and (2) does so recklessly. Once a contractor satisfies these statutory elements for IAP status, the Comptroller is empowered to issue a cease-and-desist order if the IAP has engaged in an unsafe and unsound practice "in conducting the business of" an insured depository institution. 12 U.S.C. § 1818(b)(1). IAP status also empowers the Comptroller to impose a second-tier CMP where the IAP recklessly engages in an unsafe or unsound practice "in conducting the affairs" of an insured depository institution, that results in loss to the institution, gain to the respondent, or is part of a pattern of misconduct. 12 U.S.C. § 1818(i)(2)(B)(II).

Here, Grant Thornton, a nationally recognized accounting firm, conducted an external audit of Keystone required by a formal supervisory agreement ("Formal Agreement") between the bank and the OCC. Grant Thornton acknowledged that its audit of Keystone was a "maximum risk" audit, and issued an unqualified opinion stating that, after following 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 GAAP. The Comptroller concluded that Grant Thornton acted recklessly in auditing Keystone's 1998 financial statements. The Comptroller found that in the circumstances of an acknowledged high risk audit Grant Thornton was reckless because Grant Thornton: (1) never changed its audit plan to reflect the risks presented by the Keystone audit and failed to conduct a Comprehensive audit calling for the highest level of professional scrutiny and detailed testing as its own audit manual required under the circumstances; (2) ignored a written confirmation from Keystone's principal asset servicer evidencing that Keystone did not own 25 percent of the assets it was reporting; (3) failed to review 12 monthly remittances that would have shown that Keystone was receiving almost none of the $98 million in interest income it was reporting and instead verified Keystone's reported income using data it knew was unreliable or unacceptable in the circumstances; and (4) ignored its obligation to understand Keystone's securitization business. Grant Thornton's issuance of its unqualified audit opinion enabled Keystone to continue operations and incur additional financial losses, including the payment of over $1 million in dividends. Several months after the issuance of the audit opinion, the OCC discovered through information obtained from the bank's asset servicers that the bank was hopelessly insolvent and, in September 1999, appointed the FDIC as receiver.

On December 7, 2006, based on his review of the entire record of enforcement proceedings against Grant Thornton, the Comptroller rejected the Administrative Law Judge's ("ALJ") recommendation of dismissal and issued a final decision (the "Decision") in which he concluded that Grant Thornton in connection with its audit of Keystone's financial statements for calendar year 1998 met the statutory definition of an IAP, and the statutory requirements for issuance of a C&D Order and imposition of a CMP Order. The Comptroller's Decision was supported with 264 separate findings of fact and conclusions of law.

COUNTER-STATEMENT OF THE FACTS

A. Keystone Entered the Securitization Business in 1992

Six years prior to Grant Thornton's audit of Keystone's 1998 financial statements, Keystone began growing rapidly through the securitization of high-loan-to-value, second and third mortgage loans. FD 4; FF 83. Keystone would acquire loans from large originators located throughout the country, using brokered deposits and Federal Home Loan Bank of Pittsburgh ("FHLB-Pittsburgh") advances to fund these acquisitions. FD 4; FF 84. Keystone utilized asset servicers to collect the principal, interest and penalties on the loans held prior to the securitization, and the servicers sent Keystone monthly checks representing interest income from the loans. FD 4; FF 86. Between 1992 and 1997, Keystone's asset size reportedly grew from approximately $100 million to $1 billion. FD 5; FF 82, 83.

B. Keystone's Securitization Model Changed In Early 1998

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***. FD 5; FF 89. Keystone notified United of loans available for acquisition and United would provide funding for their acquisition. FD 5; FF 89, 90. Asset servicers serviced the loans owned by United up to the time of the next securitization. FD 5; FF 94. Because United owned the loans, the servicers sent United, not Keystone, monthly interest income checks for the loans serviced for United. FD 5; FF 96. In 1998, United acquired approximately $960 million in loans under this arrangement, and Keystone executed two securitizations (May and September) using approximately $500 million in loans owned by United. FD 5; FF 102-103.

C. The "Formal Agreement" and the Engagement of Grant Thornton

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") pursuant to 12 U.S.C. §§ 161, 1817(a)(3). FD 5–6; FF 127.

The OCC's 1997 Report of Examination ("ROE") advised that supervision of Keystone had been transferred to the Special Supervision Division in Washington, D.C., and assigned Keystone an unsatisfactory composite CAMELS rating of "3," and an unsatisfactory management rating of "4."[1] FD 6; FF 128–129. In February 1998, the OCC required Keystone to amend the bank's 1997 Call Reports to correct serious and continuing inaccuracies in the financial information presented. FD 6; FF 130. The OCC also told Keystone that many of the accounting and internal controls problems noted in the 1997 ROE had not been addressed. FD 6; FF 130. On May 8, 1998, the OCC advised Keystone of potential CMPs related to its inaccurate 1997 Call Reports, and Keystone's directors and officers consented to imposition of the CMPs in December 1998. FD 6; FF 131.

In May 1998, Keystone and the OCC entered into a Formal Agreement related to the accounting and reporting irregularities noted in the OCC's 1997 ROE. FD 6; 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. FD 6; FF 133–134. The Formal Agreement also required that the bank's local auditors be replaced by a national accounting firm. FD 7; FF 133.

In June 1998, the OCC informed Keystone that it was "undercapitalized" and, accordingly, Keystone was prohibited from accepting, renewing, or rolling

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[1] CAMELS is a supervisory rating system used by bank examiners to assess a bank's condition from 1 (best) to 5 (worst). Tr. 74 (Schneck).

over brokered deposits. FD 7; FF 135. In addition, the FHLB-Pittsburgh began requiring physical possession of loans used by Keystone as collateral for FHLB-Pittsburgh borrowings. FD 7; FF 135. Being "undercapitalized" also meant that Keystone was restricted in terms of asset growth and prohibited from paying dividends. FD 7; 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 of the bank's 1998 financial statements did not begin until late December 1998.[2] FD 7; FF 137–138. Grant Thornton was aware of the OCC's 1997 ROE and the Formal Agreement, and aware that the OCC's 1998 ROE downgraded the bank's composite CAMELS rating from "3" to "4," and the management rating from "4" to "5." FD 7; FF 136, 139, 140, 150.

In 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

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[2] Grant Thornton underbid its audit work in order to position itself to sell non-audit services to Keystone. OCC Ex. 38 at GT/F 06073; Tr. 1953–1955 (Quay).

million (almost ten percent of the bank's reported assets) in connection with three separate misstatements. FD 7; FF 139. The OCC stated that Keystone was dominated by its Senior Vice President, Terry Church, who functioned as the bank's President ("Controlling Officer"), and that she appeared to have deliberately mischaracterized $760 million of the bank's assets in calculating the bank's risk-based capital for call reporting purposes. FD 7–8; FF 140–142, 169.

The asset misclassification by Keystone's Controlling Officer had the effect of erroneously categorizing Keystone as "well capitalized" under the prompt corrective action standards of FDICIA. FD 8; FF 140–142. Once OCC examiners confirmed that Keystone was not "well capitalized," Keystone's use of brokered deposits as a funding source was restricted. FD 8; FF 142–143, 149. The OCC informed the bank's Controlling Officer and others at Keystone that the OCC was contemplating assessing new CMPs against them in connection with the findings in the OCC's 1998 ROE.[3] FD 8; FF 151.

[3] In July 1999, the OCC assessed a $100,000 CMP against Keystone's Controlling Officer, and $25,000 CMPs against other officers and directors. FF 151. These CMPs were stayed when the OCC closed the bank and appointed the FDIC as receiver.

D. Grant Thornton's Pre-audit Risk Assessment and Audit Plan

1. Generally Accepted Auditing Standards

Auditors are required by 12 U.S.C. § 1831m(f)(1) to comply with GAAS in auditing insured depository institutions. GAAS requires that auditors possess appropriate skill and training, maintain an independent mental attitude, and exercise "due professional care." FD 8; FF 15, 22–28. "Due professional care" requires the auditor to plan and perform the audit in order to obtain reasonable assurance that audited financial statements are free from material misstatements whether caused by error or fraud. FD 8; FF 22, 29. 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. FF 24 "Due professional care requires the auditor to exercise *professional skepticism*." FD 8-9; FF 25 (GT Ex. 210 (AU 230.07) (emphasis in original)). "Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence." FD 8 n.7; FF 25. Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. FD 8 n.7. FF 16, 27. "Professional skepticism" dictates that an auditor not be satisfied with less than persuasive evidence. FD 8-9; FF 26. Accordingly, GAAS requires that "significant" confirmations be obtained in writing (FD 9; FF 70, 73) and that the confirmation be evaluated with "professional skepticism." FF 73.

2. <u>The Risk Assessment Dictates Required Procedures</u>

GAAS requires auditors to assess the risk of material misstatements in audited financial statements (whether caused by error or fraud). FD 9; FF 38, 63. To properly assess this risk, the auditor is required to obtain a level of knowledge of the entity's business sufficient to understand the events, transactions, and practices that may have a significant effect upon the financial statements. FD 9; FF 18–21. The auditor's understanding of the entity's internal controls may heighten concern about the possibility of material misstatements and impact the nature, timing, and extent of tests to be performed. FD 9; 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. FD 9; FF 47. Higher detection risk 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. FD 9; FF 32, 36, 41, 59.

In addition to its obligation to follow GAAS, through settlement, the Office of Thrift Supervision ("OTS") and Grant Thornton agreed to an order (the "OTS

Order") that required Grant Thornton to test a depository institution's internal controls for reliability prior to relying upon tests based upon internally generated bank financial data. FD 10; FF 5–6.

3. <u>Keystone Was a High-Risk Audit</u>

Grant Thornton staffed the audit with a lead auditor, Mr. Stanley Quay ("Lead Auditor"), and a project manager, Ms. Susan Buenger ("Project Manager"). FF 117, 124. The Project Manager conducted the pre-audit risk assessment required by GAAS and the OTS Order to determine what procedures were necessary to carry out the audit. FF 152, 172, 184. Grant Thornton planned the audit of Keystone with knowledge of the following facts that clearly demonstrated heightened audit risk:

(1) Grant Thornton had been retained by Keystone 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, including a "reconciliation between the Bank's records and loan servicer records" (OCC Ex. 353 at GT/F 07227), and to establish an internal control structure (FD 10; FF 132–134, 137–138);

(2) in a short period of time Keystone had grown rapidly in asset size and profitability (FD 10; FF 82, 83);

(3) Keystone was heavily involved in significant and complex securitizations (FD 10; FF 126, 133);

(4) Keystone faced significant liquidity risk (FD 10; FF 148, 149, 167);

(5) Keystone was troubled and undercapitalized (FD 10; FF 135, 149, 167);

(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" (FD 10; FF 150);

(7) the FBI had investigated Keystone's Controlling Officer with respect to illegal "kickbacks" related to the bank's residential lending (FD 10-11; FF 171);

(8) Michael Graham, a vice president of Keystone Mortgage Corporation ("KMC"), a bank subsidiary, was cited by the OCC as being responsible for an unexplained $31 million "input error" in the bank's accounting for residual assets (FD 11; FF 139);

(9) Keystone recently had recorded ownership of $44 million in trust accounts even though they were not Keystone assets (FD 11; FF 139);

(10) Keystone recently had claimed ownership of $16 million in residual interests in securitizations even though Keystone had pledged those interests to other parties (FD 11; 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 (FD 11; FF 130, 131, 147, 151); and

(12) OCC examiners had indicated that the bank's Controlling Officer was manipulating Call Reports so that the bank's status under FDICIA continued to be reported, inaccurately, as "well capitalized" (FD 11; FF 140).

4. Grant Thornton's Initial Failure to Assess Audit Risk at the "Maximum"

Despite the numerous red flags indicating the high risk that Keystone's financial statements would contain material misstatements, Grant Thornton initially did ***not*** assess that risk at the "maximum," a level that would have required an audit plan calling for the highest level of scrutiny and evidence in auditing the bank's financial statements. FF 173. Instead, the Project Manager assessed the risk at "slightly below maximum." FF 174. Based upon this initial risk assessment, Grant Thornton prepared what its audit manual termed a "Basic" audit plan. FF 176–177, 182–183.

Although the plan properly called for Grant Thornton to obtain written confirmations from the bank's asset servicers to make sure that they were, in fact, servicing the loans Keystone was reporting on its balance sheet (FF 179), the plan still called for Grant Thornton to audit Keystone's $98 million in reported interest income only by using a "test of reasonableness," *i.e.*, a simple comparison of reported income to reported assets, based upon ***unverified*** income figures provided by Keystone, to see if the relationship looked reasonable. FD 12; FF 176, 179–180, 219, 236–237. This is the same procedure that the Project Manager, the employee Grant Thornton placed in charge of confirming assets and verifying interest income associated with loans held for securitizations,[4] had used in all of her bank audits, none of which had been high-risk audits calling for enhanced procedures. FF 183, 187. Moreover, in conducting the "test of reasonableness," Grant Thornton planned to accept the reported income figures from Keystone even though Grant Thornton: (1) did not plan to test the bank's internal controls for reliability; (2) knew that Keystone's internal control function was poor to non-existent; (3) knew Keystone's accounting records were unreliable; and (4) did not plan to independently verify the accuracy of the income figures to be provided by management. FF 166, 179, 230–236.

[4] References to asset confirmation and income verification throughout the brief mean confirmation of the amount of loans owned by Keystone at the end of 1998 and held by asset servicers for future securitizations, and verification of the amount of income generated by Keystone-owned loans held for securitization throughout all 1998.

5. <u>The Audit Plan Was Never Amended</u>

Sometime after the basic audit plan was prepared, off-site Grant Thornton auditors, upon reviewing the plan, disagreed with the Project Manager's pre-audit risk assessment and required that the audit be assessed as one involving a "maximum" risk of material misstatements. FF 184. In response, the words "slightly below" in the initial environmental assessment were literally scratched-out, changing the risk assessment to "maximum." FF 184. However, ***the audit plan itself was never amended.***

Under the Grant Thornton audit manual and consistent with GAAS, a "maximum" assessment for environmental risk required Grant Thornton to conduct what the manual defined as a "Comprehensive" audit, *i.e.*, one that called for the highest level of detailed testing of the three audit categories recognized by Grant Thornton ("Analytical," "Basic," and "Comprehensive"). FD 11; FF 185–186. In a high-risk audit, GAAS requires "tests of details" not only for asset verification, but for verification of interest income where efficient and effective. FF 185, 225, 227–228. Nonetheless, Grant Thornton still proceeded to conduct its "Basic" audit that required only a "test of reasonableness" based on unverified data to audit reported income. FD 38-39; FF 179, 189.

E. The Audit of Keystone's 1998 Financial Statements

Proper verification of the assets and income reported by Keystone was central to Grant Thornton's responsibility to issue an opinion regarding the accuracy of Keystone's financial statements. However, Grant Thornton did not comply with GAAS in obtaining that verification.

1. The Verification of Keystone's Reported Assets

To verify Keystone assets, the Project Manager sent Advanta Mortgage Corporation USA ("Advanta"), one of the two primary companies reportedly servicing loans owned by Keystone, a written request that Advanta confirm in writing the amount of Keystone-owned loans it was servicing.[5] FD 12; FF 197. Advanta's written response stated that it was servicing $6.3 million in Keystone loans, referring to Keystone as the "Investor" under "Investor # 405." FD 12; FF 200. This figure was substantially different from the $242 million in loans the bank was reporting. FD 12; FF 200. Grant Thornton's Project Manager followed up several weeks later with a ***telephone call*** to Advanta and, according

[5] A request letter was sent to the other primary asset servicer, Compu-Link Loans Service, Inc. ("Compu-Link"), for written confirmation that Compu-Link was servicing $227 million in Keystone loans. Though servicing only $14 million in Keystone-owned loans, Compu-Link errantly sent a confirmation letter to Grant Thornton stating that it was servicing $227 million in Keystone-owned loans. FF 200.

to Grant Thornton, was ***told*** that there was another pool of Keystone loans in the amount of $236 million. FD 12; FF 202. Immediately after this call, however, Advanta sent an e-mail to the Project Manager stating that Advanta was servicing $236 million in loans for "Investor" "United National Bank" under "Investor # 406." FD 12; FF 203. Despite this significant discrepancy, Grant Thornton did not request that Advanta reconcile the conflicting information about ownership of the loans either orally or, as required by GAAS, in writing, but concluded that Advanta was servicing $242 million in Keystone loans ($6.3 million + $236 million). FD 12-13; FF 212. In reality, Advanta was servicing only $6.3 million in Keystone loans – as it had stated in its written response to the confirmation request. FD 13; FF 216.

2. <u>The Verification of Keystone's Reported Income</u>

In connection with the audit of Keystone's reported $98 million in interest income, 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. FD 13; FF 66. These tests were based upon unreliable financial information that Grant Thornton obtained directly from Keystone and failed to independently assess for accuracy. FD 13; FF 236, 237.

Keystone overstated its interest income from loans reportedly serviced by asset servicers by almost the entire $98 million. FD 13; FF 259.

Grant Thornton did not ask to review the monthly remittances that the bank received from asset servicers, which would have been evidence that the bank was receiving income from the reported assets. FF 220– 222. Nor did Grant Thornton confirm that the income was actually going into the bank's accounts by reviewing general ledger tickets and the general ledger itself. FF 226–227.

F. The Discovery of Keystone's Insolvency and the Closing of the Bank

In April 1999, Grant Thornton issued an unqualified audit opinion stating that its audit had been performed in accordance with GAAS, that Grant Thornton had obtained reasonable assurance that the bank's financial statements were free from material misstatements, and that they had been prepared in accordance with GAAP. FD 13; FF 253. However, in August 1999, OCC examiners discovered through information obtained directly from Keystone's loan servicers that Keystone was vastly overstating its assets. FD 13; FF 255–258.

After this information was brought to the attention of Grant Thornton, the auditors conducted another "test of reasonableness," but, this time, the Lead

Auditor concluded that the analytical test was inadequate for substantive testing purposes. FF 256. It was only at this point that Grant Thornton finally employed the test it should have used in the first place for a "maximum" risk audit. It conducted a "test of details," *i.e.*, reviewed the 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. FD 13–14; FF 258, 260. Nor could Grant Thornton find evidence of the reported income in the bank's general ledger tickets. FD 13–14; FF 257. In all, Keystone had overstated its 1998 interest income by nearly the entire $98 million it was reporting and its assets by approximately $450 million or approximately 50 percent of reported assets. FF 259.

The OCC closed the bank upon its determination that the bank was hopelessly insolvent and appointed the FDIC as receiver in September 1999. FF 260. Resolution of the bank cost the bank insurance fund approximately $600 million. Tr. 351 (Schneck).

Between April 1999 when Grant Thornton issued its audit report and the time the bank was placed in receivership, Keystone paid dividends totaling over $1 million. FD 14; FF 254. Subsequently, a group of Keystone insiders, including its Controlling Officer, received felony convictions for, among other things, obstruction of the OCC's 1998 bank examination, bank embezzlement, and money laundering. FD 14; FF 261.[6]

SUMMARY OF ARGUMENT

Congress has recognized the critical role of professionals and their firms in conducting the business of insured depository institutions and in the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989) ("FIRREA"),[7] it expanded the authority of the federal banking agencies to take remedial enforcement actions against professional firms (as well as individual professionals) providing services to insured depository institutions, where the firm meets the definition of an IAP. In the case of independent contractors, such as professionals and their firms, the definition of an IAP has two components: (1) the contractor participates in an unsafe or unsound practice that causes or could cause significant financial harm to such institutions; and (2) that participation is reckless. 12 U.S.C. § 1813(u)(4).

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[6] Grant Thornton does not dispute in its opening brief the underlying facts upon which the Comptroller based his decision, only the Comptroller's interpretation of those facts.

[7] The Comptroller uses FIRREA throughout the brief to refer to the amendments to 12 U.S.C. §§ 1813 and 1818 giving the Comptroller authority to bring enforcement actions against IAPs.

The requisite standard of care for an auditor is provided by GAAS. Here Grant Thornton failed to meet that standard of care. It failed to audit Keystone's 1998 financial statement in accordance with GAAS and thus failed to detect that Keystone was overstating its assets by over $230 million and its interest income by almost $98 million. This was an unsafe or unsound practice. Grant Thornton's conduct also was reckless in the circumstances of the Keystone audit because it departed from what GAAS required in the face of obvious and known risks.

Grant Thornton failed to audit a national bank in accordance with GAAS procedures in what Grant Thornton acknowledged was a "maximum" risk audit that called for the highest level of professional scrutiny and testing of the two most material entries on the bank's financial statements. Despite its awareness that there was a high likelihood that Keystone's financial statements contained material misstatements and its knowledge of numerous "red flags" – including the fact that Grant Thornton was hired by Keystone to comply with an OCC Formal Agreement that required the bank to retain a nationally recognized auditing firm to resolve the bank's accounting inaccuracies – Grant Thornton relied upon the same audit procedures it utilized in its routine or standard audits. Because of its failure to plan for and conduct procedures appropriate for the level of risk posed by the audit as well as its failure to employ the "heightened skepticism" required by GAAS in high-risk audits, Grant Thornton failed to detect that Keystone was vastly overstating its assets and interest income.

With respect to assets reported on a bank's balance sheet, GAAS required that written confirmations be obtained from third-parties purportedly servicing those assets. Nevertheless, Grant Thornton recklessly relied upon an ***oral*** statement to confirm 25 percent of the bank's assets ($236 million) despite being in possession of written evidence (the GAAS-required written confirmation and an e-mail from that same servicer) that contradicted the oral confirmation and demonstrated that Keystone not only did not own $236 million of reported assets but provided the name of the bank that did own them.

With respect to the income statement, GAAS required in a high risk audit that monthly remittances of interest income on assets reportedly being serviced by third-parties be reviewed and verified. Despite the fact that Grant Thornton would have had to review only 12 monthly remittances from one asset servicer and trace them into the general ledger, Grant Thornton simply compared ***unverified*** income figures provided by Keystone to the bank's reported assets to see if the relationship "looked" reasonable. Its failure to conduct the required procedure and, instead, to rely upon a mere relationship test based upon unverified data in a high-risk audit where Grant Thornton knew that the bank's internal records were unreliable and the integrity of management was suspect was patently reckless. Indeed, after Grant Thornton issued its unqualified opinion based upon this procedure, Grant Thornton, in response to questions raised about the bank's solvency, ultimately conducted the income-verification procedure required by GAAS and quickly discovered, in less than an hour, that the bank had received almost none of its reported $98 million in interest income, and later discovered that Keystone did not own over $450 million in assets it was reporting.

Grant Thornton does not dispute the underlying facts upon which the Comptroller based his decision or that GAAS provides the applicable standard of care for its audit of Keystone. Instead, it principally raises legal arguments related to the Comptroller's decision that those facts established that Grant Thornton satisfied the statutory elements for IAP status under 1813(u)(4) and for imposition of administrative sanctions. Those arguments are wholly unsupported by the plain meaning and legislative history of FIRREA and the inapposite case law upon which Grant Thornton relies.

Because the Comptroller correctly concluded that Grant Thornton met the elements of IAP status based upon the record evidence, the Comptroller properly imposed a C&D Order targeted to assure that Grant Thornton conducts its audits of insured depository institutions in accordance with GAAS, and imposed an appropriate CMP of $300,000, an amount that is less than the $500,000 that Grant Thornton charged Keystone for its audit and non-audit services.

ARGUMENT

I. THE STANDARD OF REVIEW

The Court will set aside factual findings only if unsupported by substantial evidence taking into consideration the record as a whole. 5 U.S.C. § 706(2)(E) (2007); *see Proffitt v. FDIC*, 200 F.3d 855, 860 (D.C. Cir. 2000) (*quoting Pharaon v. Board of Governors of Fed. Reserve Sys.*, 135 F.3d 148, 152 (D.C. Cir. 1998). Legal conclusions will be set aside only if the Court finds them to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 702(2)(A) (2007). Even where the Court chooses not to defer to the agency's interpretation of the relevant statute, reasonable agency interpretations can carry persuasive force. *United States v. Mead Corporation*, 533 U.S. 218, 231, 234-35 (2001).

Reviewing courts normally will not disturb agency remedies and penalties unless the agency abuses its discretion or otherwise acts arbitrarily and capriciously. *First Nat'l Bank of Bellaire v. Comptroller of the Currency,* 697 F.2d 674, 686 (5th Cir. 1983).

II. THE TERM "INDEPENDENT CONTRACTOR," AS USED IN THE DEFINITION OF "IAP," APPLIES TO AUDITING FIRMS AND NOT JUST TO INDIVIDUALS

The plain meaning of the statute and its legislative history support the Comptroller's conclusion that an auditing firm can be an "independent contractor" within the meaning of 1813(u)(4). FIRREA provides that an "independent contractor" who performs services for an insured depository institution can be an IAP. 12 U.S.C. § 1813(u)(4). Grant Thornton does not dispute that Keystone engaged it, as a firm, to conduct an audit of the bank's 1998 financial statements (OCC Ex. 288); that Grant Thornton, as a firm, staffed, planned and conducted the audit; or that Grant Thornton, as a firm, signed and issued the audit opinion (FF 253).[8] Grant Thornton argues that the text of 1813(u)(4) must be read to limit IAPs to independent contractors who are "individuals" because it includes the parenthetical: "(including any attorney,

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[8] Grant Thornton, as a firm, was sued by and found liable to the FDIC as receiver for Keystone for professional malpractice in connection with the same audit. *See Grant Thornton LLP v. FDIC*, Civil Action Nos. 1:00-0655, 1:03-2199, 1:04-0043 (S.D.W.Va., March 14, 2007).

appraiser, or accountant)." Grant Thornton's attempt to re-write the definition of IAP must be rejected.

The structure of section 1813(u), which defines IAP, confirms that Congress contemplated that both natural and juristic persons could be IAPs. In defining IAPs, certain terms necessarily are limited to individuals (*e.g.*, director, officer, and employee), while others clearly can include other entities (*e.g.*, shareholder, agent, joint venture partner). Where Congress intended to exclude a particular type of person from the definition, it did so explicitly. Thus, Congress excluded bank holding companies from the term shareholder, 12 U.S.C. § 1813(u)(3), but gave no indication that other types of corporate persons should be excluded from the terms Congress broadly used to identify the types of persons that could be IAPs. Consistent with the structure of the statute, the parenthetical in 1813(u)(4), which gives illustrative examples of providers of professional services, cannot be reasonably construed as demonstrating Congressional intent to exclude corporate entities from the statute's coverage.

Any doubt about what Congress intended in adopting the new definition of IAP in FIRREA is laid to rest by the FIRREA Conference Report where the committee explained that: "[T]he new term [IAP] . . . broadens the group of individuals *and entities* covered." FIRREA Conf. Rep. No. 101-222 at 439 (emphasis added). Grant Thornton's argument (GT Br. at 22 n.5) that this language is best understood as referring solely to the categories of individuals and entities covered by 1813(u)(1), (2), and (3) is an assertion without support. Instead, the House Report to which Grant Thornton refers confirms the opposite conclusion: that Congress intended to extend FIRREA enforcement authority to reach individuals and entities in all IAP categories.

Grant Thornton cites the House Report accompanying H.R. 1278, which would have extended enforcement authority to any "'person participating in the conduct of the affairs of an insured depository institution'" including "any accountant, appraiser, or attorney . . . who knowingly or with reckless disregard participates in . . . any unsafe or unsound practice . . . which caused or is likely to cause a loss or other adverse effect." H.R. Rep. No. 101-54, 1st Sess., pt. 1, at 197 ("House Report"). But the House Report elsewhere explained that "this terminology may include . . . *independent contractors*, such as appraisers, attorneys, and consultants . . . ." *Id*. at 391-92 (emphasis added). Moreover, the House Report shows that the term "independent contractor" would permit "enforcement orders against a corporation, firm or partnership, such as a large accounting, appraisal, or law firm, since the term 'person' includes entities as well as individuals . . . ." *Id*. at 466.

The part of the House Report cited by Grant Thornton responded only to concerns by professional groups that the regulatory agencies might misuse 12 U.S.C. §1818(e)'s removal and prohibition sanctions against professional firms. While noting its expectation that this authority would be used judiciously, the Committee also stated that "the Committee strongly believes" that the agencies should be empowered to use their "removal and prohibition" powers against a "professional firm" where most or many of its senior management participated in some way in egregious misconduct. House Rep. at 466-67. There was no hint in the House Report that professional firms were not subject to enforcement actions or that it would be inappropriate to impose non-prohibition remedial sanctions and CMPs against professional firms acting as IAPs.

Grant Thornton asserts that even if "independent contractor" includes a firm, the Comptroller exceeded his authority in bringing the enforcement action in this circumstance, citing the preamble to an interagency regulation implementing provisions allowing debarment of independent public accountants, 12 U.S.C. § 1831m(g)(4), enacted by Congress as part of FDICIA in 1991.[9]

[9] Section 1831m(g)(4) permits the Comptroller to remove, suspend, or bar an independent public accountant, upon a showing of good cause, from performing for insured depository institutions audit services required by section 1831m. 12 U.S.C. § 1831m(g)(4).

Nothing in the preamble to that regulation limits the Comptroller's discretion under 12 U.S.C. § 1818 to initiate an enforcement action that seeks only non-debarment sanctions against a professional firm. Indeed, section 1831m(g)(4) expressly provides that it is "[i]n addition to any authority contained in section 1818," including, of course, the Comptroller's authority to impose a C&D order and CMP against an IAP.

The preamble language Grant Thornton identifies responds to a comment suggesting that there should be a presumption that debarment would be limited to only the most serious circumstances, citing to the FIRREA House Report discussed above, House Rep. at 466-67. Although the agencies acknowledged that their enforcement authority under section 1818 had been used against an entire firm of professionals "only in the most egregious circumstances," 68 FR 48256, 48259, that statement related to the use of 12 U.S.C. § 1818(e) enforcement authority to ***remove*** or ***prohibit*** professional firms acting as IAPs. Those are the sanctions that parallel the suspension, removal, and debarment sanctions that are the exclusive sanctions under 12 U.S.C. § 1831m(g)(4). Accordingly, while Congress and the banking agencies acknowledged concern about imposing sanctions barring a firm from auditing depository institutions based on the conduct of a limited number of individuals at the firm, nothing accompanying the final regulations implementing 12 U.S.C. § 1831m(g)(4) (or in FIRREA's legislative history) establish a policy that the OCC would never bring enforcement actions against professional firms unless a majority of the firm's members were involved in the misconduct.

III. COMPLIANCE WITH GAAS IS THE STANDARD OF CARE EXPECTED OF AN AUDITOR

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*, an IAP case involving an attorney who gave banking advice, 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. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994) (*citing Hoffman v. FDIC*, 912 F.2d 1172, 1174 (9th Cir. 1990)).

Congress has placed particular emphasis on the accountant's role in the operations of insured depository institutions by requiring them to file an annual report with their federal regulators that contains financial statements audited by an independent public accountant in accordance with GAAS, 12 U.S.C.

§§ 1831m(a)(2)(A)(ii), 1831m(d)(1), and requiring a statement by the independent auditor that the financial statements "are presented fairly in accordance with [GAAP]." 12 U.S.C. § 1831m(d)(2)(A). GAAS, therefore, provides the standard of care for conducting audits of insured depository institutions. *See also Marrie v. SEC*, 374 F.3d 1196, 1200, 1206-07 (D.C. Cir. 2004) (SEC's use of GAAS as the standard of care for audits of public companies).

The requirement that the audits be conducted in accordance with GAAS is intended to facilitate the regulation of insured institutions to assure their safety and soundness. 12 U.S.C. § 1831n(a)(1) (accounting principles applicable to reports filed with federal banking agencies should result in financial statements that accurately reflect capital, facilitate effective supervision, and facilitate prompt corrective action). Thus, the Comptroller concluded that the relevant standard of care for an audit is established by GAAS. FD at 19-20. Because the ALJ failed to compare Grant Thornton's conduct to what GAAS demanded under the circumstances of the Keystone audit, FD 20, the Comptroller properly rejected the ALJ's reasoning.

Grant Thornton argues that the "unsafe or unsound practice" relevant to finding that it is an IAP is the fraud perpetrated by Keystone's management and because the ALJ and the Comptroller found that Grant Thornton did not "participate" in that fraud Grant Thornton is not an IAP. GT Br. at 24-28. But nothing in 1813(u)(4) ties the unsafe or unsound practice of the IAP to conduct of bank insiders. GT Br. at 24. Under Grant Thornton's theory, an independent contractor could avoid responsibility as an IAP for its own misconduct separate from any act or omission of the financial institution because it would always be the misconduct of the financial institution that is the "cause" of the loss to, or the adverse effect on, the institution. Indeed, this case illustrates how an independent contractor's failed audit may proximately cause loss to a financial institution. And there is no dispute that Grant Thornton's unqualified audit opinion facilitated the payment of over $1 million in dividends to Keystone shareholders, and that this payment, in turn, harmed the bank's creditors and the FDIC because it deepened the bank's insolvency.[10] FD 43.

Through the enactment of FIRREA in 1989, Congress strengthened regulatory authority by explicitly authorizing enforcement actions against

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[10] Grant Thornton relies on *Gulf Fed. Sav. & Loan Assoc. v. Fed. Home L. Bank Bd.*, 651 F.2d 259, 264 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982), for the proposition that an "unsafe or unsound practice" necessarily means action by bank management or the bank itself. *Gulf Fed.* is based on the law as it existed *before* Congress extended the banking agencies' enforcement authority to IAPs, thus *Gulf Fed.'s* examples of unsafe or unsound practices relate to management defalcations and mismanagement by directors and officers. *See id.*

auditors whose failed audits delay regulatory action and increase the cost of failed bank resolution. 1989 U.S.C.C.A.N. at 97. *See Office of Thrift Supervision v. Ernst & Young*, 786 F. Supp. 46, 51 (D.D.C. 1992) (noting that from the beginning of the financial-institution crisis of the 1980's some institutions were given "clean audits" only to be declared insolvent shortly thereafter). Congress intended that regulatory agencies have authority to take enforcement actions against independent contractors for their misconduct in providing professional services to insured depository institutions, but Congress *did not require* that the independent contractor knowingly participate in an unsafe or unsound practice perpetrated by bank management to be an IAP.

IV. THE STANDARD FOR RECKLESSNESS IS AN OBJECTIVE ONE

A. The Comptroller Has Consistently Applied an Objective Test of Recklessness as Used in 12 U.S.C. § 1813(u)(4)

In 1994, the Comptroller interpreted the word "recklessly" in 1813(u)(4) as establishing an objective standard. *See In the Matter of Augustus I. Cavallari*, OCC–AA–EC–92–115 (1994). The *Cavallari* enforcement action involved a determination that an attorney acted as an IAP. In that decision, the Comptroller explicitly recognized that the law defines "recklessness" differently in civil and criminal situations, and proceeded to apply the standard applicable in the civil context:

> For purposes of tort law, "[t]he usual meaning assigned to . . . 'reckless' . . . is that the actor has intentionally done an act of an unreasonable character in disregard of a known or obvious risk that was so great as to make it highly probable that harm would follow, and which thus is usually accompanied by a conscious indifference to the consequences."

Id. at 10 (*citing* Liability of Attorneys, Accountants, Appraisers and Other Independent Contractors under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 42 Hastings L. J. 249, 274 n.157 (1990) (*quoting* W. Prosser & W. Keeton, The Law of Torts 213 (5th Ed. 1984) for the civil standard)). The Comptroller's decision in *Cavallari* also cited *Simpson v. OTS*, 29 F.3d 1418, 1425 (9th Cir. 1994), which adopted a civil recklessness standard in another enforcement context under 12 U.S.C. § 1818(b)(6)(A)(ii).[11] *Id.* at 10. Under this standard, an IAP acts recklessly where the IAP disregards a known or obvious risk of a substantial harm. Although recklessness is often accompanied by evidence of a conscious indifference to the risk, conscious indifference is not

[11] Although the Comptroller in *Cavallari* observed that other courts in different contexts, including civil fraud actions under the securities laws, had applied similar definitions of recklessness, the Comptroller did not adopt the standard in those cases.

a necessary element of recklessness under the objective test used in civil cases. Paraphrasing the Comptroller, the Second Circuit applied this standard in Cavallari's appeal of the Comptroller's final decision:

> FIRREA does not define recklessness. The Comptroller relied on authority holding that an act is reckless if done in disregard of, and evidencing a conscious indifference to, a known or obvious risk of a substantial harm.

Cavallari, 57 F.3d at 142.

Grant Thornton seeks to replace the Comptroller's objective test for recklessness with a subjective test requiring proof of "scienter," as used in civil actions brought under the anti-fraud provisions of the Securities and Exchange Commission Act of 1934. GT Br. at 28-30. In Grant Thornton's view, auditors who believed in good faith that they were acting consistent with GAAS could not be found to be acting recklessly no matter what GAAS actually required in the circumstances. GT Br. at 29. Its interpretation, however, is inconsistent with the way "reckless" conduct has been interpreted by the Comptroller in actions involving IAPs, with the Supreme Court' s interpretation of reckless in civil cases, and is flatly contrary to the intent of Congress in expanding banking agencies' ability to take enforcement action against independent contractors whose reckless conduct had contributed to losses at financial institutions.

Under the bank regulatory statutes, conduct is reckless if it is undertaken in disregard of a known or obvious risk of substantial harm. It does not require that actors subjectively know or intend that their conduct will result in harm, only that an objective observer in the circumstances would recognize the obvious risk of substantial harm and take required steps to avoid it. Thus, the standard precludes the necessity of finding "intent" or "scienter" to conclude that an IAP acted "recklessly." While Congress made clear that conduct by an independent contractor had to depart so far from the required standard of care as to constitute recklessness in order for that contractor to come within the definition of an IAP, Congress did not intend that the independent contractor's subjective beliefs about its compliance with the standards applicable to its work would shield the independent contractor from sanctions under the banking laws. This is evident from the text of 1813(u)(4), which makes "knowing" as well as "reckless" conduct a basis for finding an independent contractor to be an IAP. Whether in undertaking to provide general business advice, *see Cavallari*, or to provide auditing services, as is the case here, the contractor is held to the objective standard of care applicable to the service being provided, and the contractor's subjective belief about whether its conduct meets required standards does no more than to distinguish between knowing and reckless conduct.

Use of this objective standard for reckless conduct is wholly supported by the Supreme Court's recent decision in *Safeco Ins. Co. of America v. Burr*, 127 S. Ct. 2201 (2007). There, the Court held that "reckless disregard" sufficient to trigger civil liability under the federal Fair Credit Reporting Act calls for an objective standard, citing *Farmer v. Brennan,* 511 U.S. 825 (1994), and Prosser and Keeton § 34, at 213-214. *Id.* at 2215. The *Safeco* Court contrasted civil and criminal recklessness explaining: "Unlike civil recklessness, criminal recklessness also requires subjective knowledge on the part of the offender. *Brennan*, 511 U.S., at 836-837; ALI, Model Penal Code § 2.02(2)(c) (1985)." *Id.* at 2215 n.18; *see also id.* at 2208-09.

Different statutory schemes may involve different standards for recklessness. Thus, Grant Thornton's reliance upon *Saba v. Compagnie Convention Nationale Air France*, 78 F.3d 664 (D.C. Cir. 1996), is misplaced. While this Court concluded in the context of the Warsaw Convention that the phrase "equivalent to willful misconduct" was intended "to serve a limited function: providing a proxy for willful misconduct's scienter requirement," *id.* at 667, this case involves banking law. The unique considerations involved in *Saba*, as well as *Saba*'s reference to the similarly unique considerations involved in federal securities fraud cases (where proof of intent is required by statute), have no application here. *Id.* 668-69.

Nothing in the text of 1813(u)(4) *equates* “recklessly” with “knowing.” The broadening of enforcement authority to IAPs was to address cases of “serious misconduct” – not “willful misconduct.” House Rep. at 466. And, unlike the federal securities laws, there is nothing in 1813(u)(4) that suggests that “recklessly” requires a finding of “intent” or “scienter” before banking agencies may take a civil enforcement action against an IAP. In FIRREA, Congress addressed the serious problems caused by independent contractors who provided ineffective professional services to insured depositories institutions, not just contractors knowingly engaged in misconduct. FD 18–19. As the Comptroller long ago concluded, as the Second Circuit agreed in *Cavallari*, and consistent with the analysis of the meaning of recklessness by the Supreme Court in other federal statutes, recklessness under the banking laws calls for an objective test and none of the securities law cases cited by Grant Thornton are applicable.

Indeed, even in SEC enforcement cases against auditors, where “recklessness” is considered “a lesser form of intent,” auditors can be found liable, regardless of their subjective intent, for extreme departures from GAAS.

In *Marrie v. SEC*, the SEC, pursuant to Rule 102(e),[12] brought an administrative enforcement action against two accountants in connection with the audit of a public company. The SEC alleged that they had recklessly violated GAAS by failing to exercise appropriate professional skepticism, obtain sufficient competent evidential matter, or adequately supervise field work in connection with certain aspects of the audit and that the audit constituted an "extreme departure from professional standards." *Marrie v. SEC*, 374 F.3d at 1199-1200. The administrative law judge dismissed the charges concluding that the auditors had not acted recklessly because there was no evidence that the auditors intended to aid in the fraud by the audited company. *Id.* at 1200. The SEC reversed the dismissal of charges concluding that the relevant question was whether the accountants recklessly violated applicable professional standards. *Id.*

This Court agreed, concluding that the SEC could reasonably conclude that "any licensed accountant is on notice of professional standards generally and of what constitutes extreme departures in particular," citing to many of the same GAAS standards applicable to this case. *Id*. at 1205-06. "Under the

[12] Rule102(e) provides, in part, that "improper professional conduct" "means '[i]ntentional or knowing conduct, including reckless conduct that results in a violation of applicable standards.' 17 C.F.R. § 201.102(e)(1)(iv)(A)." *Id*. at 1203.

circumstances, the Commission could reasonably conclude that the failure to obtain the necessary documentation was an ***extreme*** departure from professional standards." *Id.* at 1206 (emphasis added).

B. There Is No "Good Faith" Defense to Recklessness in this Context

Because recklessness under FIRREA is based on an objective standard, subjective "good faith" has the same limited role in determining whether an independent contractor's conduct brings the contractor within the definition of an IAP as the contractor's subjective intent: it can distinguish between knowing and reckless conduct. Thus, Grant Thornton misconstrues *Cavallari* in citing it for the proposition that 1813(u)(4) contains a "good faith" defense. GT Br. at 29. There, citing the House Report discussed above, the Second Circuit explained that the IAP, an attorney, "did not provide the kind of good faith legal advice that FIRREA shields." *Cavallari*, 57 F.3d at 142. But that legislative history related *solely* to concerns about the impact of the inclusion of attorneys as potential IAPs under FIRREA on the attorney-client relationship between financial institutions and their attorneys. Responding to this concern, the House Report stated: "By specifying 'attorney' in this section, the Committee does not intend to subject attorneys to agency enforcement actions for those good faith activities falling within the traditional attorney-client relationship." H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1, at 467.

Auditors serve a public function. FF 11. There is nothing equivalent to the attorney-client privilege governing auditors' relations with their audit customers, and Congressional concern about the ability of attorneys to give "good faith" legal advice to their clients has no application to the type of audit services Grant Thornton was providing to Keystone in this case.

Congress did not explicitly include in FIRREA a subjective "good faith" exception to IAP liability. *Cf. Marrie v. SEC*, 374 F.3d at 1204 (in SEC administrative enforcement action against auditors for recklessness, good faith is not a defense but might be a mitigating factor); *see* 12 U.S.C. § 1818(i)(2)(G) (providing that good faith is mitigating factor in CMP action against IAPs). Nor is there anything to indicate that Congress would have intended such an exception to apply in this context.

V. SUBSTANTIAL EVIDENCE SUPPORTS THE CONCLUSION THAT GRANT THORNTON'S VIOLATIONS OF GAAS WERE RECKLESS

Substantial evidence shows, and it is undisputed, that the known and obvious conditions at Keystone presented a maximum risk that Keystone's financial statements would contain material misstatements. Substantial evidence shows, and it is undisputed, that Grant Thornton initially planned the Keystone audit as a "Basic" audit. FF 182–184. Substantial evidence shows, and it is undisputed, that Grant Thornton subsequently determined that the Keystone audit represented a maximum risk audit, which under Grant Thornton's interpretation of GAAS called for the highest level of scrutiny and documentation of the evidence supporting Keystone's financial statements. FF 184–185, 188. It is in the context of these undisputed circumstances that the Comptroller found Grant Thornton's multiple failures to comply with GAAS to be reckless.

A. Substantial Evidence Supports the Conclusion that Grant Thornton Violated GAAS

1. The Audit of Reported Assets

There is no dispute that in the context of the Keystone audit, GAAS required significant assets reported on Keystone's balance sheet to be confirmed *in writing*. FF 193. The evidence is undisputed that Grant Thornton did not obtain written confirmation of Keystone's assets serviced by Advanta as required by GAAS. FF 190–217. Indeed, there is no dispute that the only two written responses that Grant Thornton received from Advanta– a formal letter stating that Advanta was servicing $6.3 million in Keystone assets and an e-mail that

Advanta was servicing $236 million in United Bank assets – demonstrated that Advanta was not servicing $242 million in Keystone loans as the bank was reporting. FF 200, 203.

The Comptroller properly rejected the ALJ's decision that excused Grant Thornton's failure to discover that Advanta was servicing only $6.3 million in Keystone loans based upon the ALJ's unsubstantiated belief that bank management must have interfered with Grant Thornton's confirmation efforts with Advanta. FD 21. There was no evidence of interference in the Advanta confirmation process and, further, the mere presence of such manipulation, in and of itself, does not relieve the auditor of its obligation to follow GAAS. *Id.*

Grant Thornton mounts several challenges to the Comptroller's conclusion. First, Grant Thornton asserts that the Comptroller "misrepresented" the evidence when he found that the e-mail stated that United "owned" the loans, when the e-mail stated that the "Investor" for "Investor # 406" was United. GT Br. at 38. But Advanta's earlier formal written response to Grant Thornton's confirmation request that it was servicing $6.3 million in Keystone loans used the same terms in identifying Keystone as the "Investor" owning loans serviced for "Investor # 405," and the Project Manager had no difficulty understanding that this meant Keystone owned that $6.3 million in loans. FF 201; OCC Ex. 329 at GT001140; GT Ex. 1B at GT001140; FF 200.

Grant Thornton asserts that there was "no legitimate" explanation on the record for why Advanta would have sent an e-mail concerning United assets. GT Br. at 39. However, GAAS requires that the auditor have a "questioning mind" and obtain appropriate evidence to support ownership of reported assets. FF 25. Grant Thornton was required to obtain written evidence from the servicers showing that Keystone owned the loans it was reporting. FF 193. Regardless of why Advanta sent the e-mail, the evidence showed that Grant Thornton received written statements indicating that Keystone did not own most of the loans it was reporting, but Grant Thornton stated that the bank did own the loans solely on the strength of an oral statement. Grant Thornton's failure to assess the competency and sufficiency of the evidence upon which it relied was a violation of an auditor's responsibility to exercise professional skepticism. FF 25, 27.

The audit experts reached the same conclusion. Mr. Potter, the OCC's expert, 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, but nevertheless supported Grant Thornton's reliance upon an oral communication by testifying that it was not an "oral confirmation," which does not comply with GAAS, FF 70, 215, but rather "support for the reconciliation between Advanta's formal letter response and what's [reportedly] on their books." Tr. 3109, 3113 (Goldman). The Comptroller did not credit this testimony because Mr. Goldman's hearing testimony contradicted his earlier deposition testimony where, like Mr. Potter, he testified that the telephone conversation was an oral confirmation. FD 25–26; Tr. 3109–3112 (Goldman). The Comptroller similarly rejected Mr. Goldman's testimony that Grant Thornton was entitled to rely upon the oral conversation given Advanta's policy against releasing information about other clients because Mr. Goldman failed to identify any applicable GAAS exception to the written-confirmation requirement that would support his opinion. FD 26; FF 207.

Finally, the Comptroller found that none of the other evidence Grant Thornton offered to bolster the propriety of its failure to satisfy GAAS requirements to obtain written confirmation of Keystone's assets was sufficient to be competent evidential material as required by GAAS. FD 26 n.18, 27 n.19. Ultimately, even Grant Thornton's expert, Mr. Goldman, acknowledged that none of this evidence was sufficient to comply with GAAS's written confirmation requirement. FD 26–27; Tr. 3104 (Goldman).

2. The Audit of Reported Interest Income

a. GAAS Required a "Test of Details"

Substantial evidence supports the Comptroller's conclusion that, in the Keystone audit, Grant Thornton was required to review the monthly remittances from third-party asset servicers and to trace the income reported in those remittances into the bank's general ledger. Under GAAS, in a high-risk audit, a "test of details," where it is efficient and effective, is mandated for ***both*** balance sheet and income statement verification, as Mr. Potter testified. FF 67, 160, 162, 220, 228. A "test of details" refers to a substantive test that requires review of primary financial documents, such as remittances and cash receipts, and traces those items into the banks records. FF 64. That level of testing is what distinguishes high-risk audits from Grant Thornton's "Basic" audit. Grant Thornton mischaracterizes GAAS requirements when it argues that it did not need to perform a "test of details" on interest income in the circumstances of the Keystone audit because Grant Thornton had obtained written confirmations from the third-party asset servicers. GT Br. at 46. As the Comptroller found in rejecting the ALJ's reasoning, Grant Thornton cannot bootstrap itself into compliance with GAAS income verification requirements by pointing to its asset confirmation procedures (which also failed to comply with GAAS). FD 30-31.

Grant Thornton challenges the Comptroller's "entire analysis" of Grant Thornton's inappropriate use of a "test of reasonableness," contending that the Comptroller inaccurately paraphrased AU 329.12, which addresses circumstances where GAAS allows an analytical test to be used as a substantive test in place of a test of details.[13] GT Br. 45. But as Mr. Potter opined with respect to AU 329.12, in a high-risk audit an auditor may bypass a "test of details" ***only*** where potential misstatements would not be apparent from an examination of the detailed evidence or where the detailed evidence is not readily available. FF 67, 228; Tr. 2722– 2726 (Potter). Based upon the facts in evidence in this case, Mr. Potter concluded that Grant Thornton failed to follow GAAS in its audit of reported interest income because a "test of details" was necessary and possible to perform. FF 228. Although Grant Thornton suggests

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[13] An auditor's opinion must be based upon sufficient competent evidential matter. FF 16. A "substantive test" refers to the nature, timing, and extent of auditing procedures necessary to detect material misstatements *based upon the risk assessment*. FF 59; *see also* FF 64. An auditor may not rely upon an entity's internal controls in performing analytical tests without testing those controls for accuracy (FF 232; *see also* FF 6, 68), and an auditor may not use information obtained from the entity for substantive testing purposes without obtaining evidence of its accuracy and completeness. FF 234–235.

that Mr. Potter, at a different point in his testimony, stated that he did not object to using analytical procedures generally in a bank audit, Mr. Potter consistently testified that in the Keystone audit a "test of details" was both efficient and effective in assuring that the income was actually "coming in," and was necessary in light of the risks posed by the Keystone audit. Tr. 2892 (Potter).

Grant Thornton challenges the Comptroller's conclusion that Grant Thornton failed to comply with GAAS in conducting a "Basic" rather than a "Comprehensive" audit, a distinction derived from Grant Thornton's audit manual. GT Br. at 42. The Comptroller's Decision is fully supported by relevant GAAS standards, including AU 161, which requires an auditing firm to develop its own procedures to assist its auditors in the implementation of GAAS. FF 74. Expert testimony established that Grant Thornton's manual generally achieved the objective of AU 161. Tr. 2886-87. Grant Thornton's manual described the types of audit procedures GAAS required based upon the audit risk assessment (FF 160–162) and provided that when environmental risk is assessed at the highest level ("maximum"), then "tests of details" (what the manual describes as a "Comprehensive" audit) were to be conducted for income statement verification. FF 162. In fact, even Grant Thornton concedes that GAAS, as reflected in its audit manual, "required a 'Comprehensive' audit in the

Keystone context." GT Br. at 43; FF 74-81, 152-162. Thus, there is really no dispute that Grant Thornton was required to conduct an effective substantive test to verify interest income in the circumstances of the Keystone audit. But Grant Thornton did not.

Lastly, Grant Thornton attempts to justify its failure to conduct a "test of details" by pointing to the ALJ's determination that Grant Thornton was justified in performing an analytical test because of its concerns about Keystone's documents. GT Br. at 44. However, GAAS provides no such exception applicable in the Keystone circumstances. *See* FD 28, 37.

b. The Analytical Tests of Interest Income Did Not Provide the Evidence Required by GAAS

Even if an analytical test ("test of reasonableness") could have been substituted for a "test of details" in auditing interest income, substantial evidence supports the Comptroller's conclusion that the tests employed by Grant Thornton did not provide the evidence required by GAAS and, therefore, neither could be used as a substitute for a "test of details."

Grant Thornton's first "test of reasonableness" regarding Keystone's interest income was not an appropriate test because it relied on a schedule prepared by a bank insider containing financial data that was wholly unreliable.

FF 68, 232–243. Grant Thornton knew Keystone's internal controls and accounting data were unreliable, and both experts agreed that GAAS required Grant Thornton to test for accuracy all financial data provided by Keystone's management. FF 164–165; Tr. 2729-30 (Potter); Tr. 3058 (Goldman). Grant Thornton's Project Manager admitted that Grant Thornton did not test the reliability of the financial data that bank management provided Grant Thornton during the interest-income testing phase, including the insider-prepared schedule. FF 236.

Grant Thornton criticizes the Comptroller's analysis for faulting the Project Manager's "reliance on the Call Reports – the source of three-quarters of data used in the first test." GT Br. at 48. But the evidence showed that the Project Manager used three months of unverified data from the insider-prepared schedule, which she knew was unreliable, because she could ***not*** use the Call Reports since they were inaccurate and being restated. FF 236–240; Tr. 2424–2426 (Buenger); OCC Ex. 294 at GT001299.

As the Comptroller acknowledged (FD 33; FF 245) (contrary to Grant Thornton's assertion (GT Br. at 50)), Grant Thornton's Project Manager, based on her concerns about the first test, conducted a second "test of reasonableness" using a purported Compu-Link remittance for December 1998. FF 245.

Substantial evidence supports the Comptroller's conclusion that the use of the purported December 1998 Compu-Link remittance violated GAAS for several reasons. GAAS required that Grant Thornton track the interest income in the purported December 1998 remittance into the bank's records to make certain that the reported monthly income of $10 million was actually received by Keystone. FF 220–227; Tr. 2874-76 (Potter). Grant Thornton did not do this, although in August 1999 after the audit had been completed and just prior to the bank's failure, Grant Thornton's Project Manager, upon reviewing "general ledger tickets" for documentation to support reported income, was unable to find any support for the income Keystone reported and Grant Thornton claimed to have verified. FF 257.

Reliance upon the purported remittance violated GAAS's requirement that auditors maintain appropriate professional skepticism. FF 245–251. The remittance, a one-page document, was attached to a one-line letter from Compu-Link stating that a trial balance was attached. There is no dispute that a one-page remittance – not "a detailed trial balance" – was attached to the letter. FF 247. Furthermore, the remittance was not on Compu-Link letterhead and did not indicate that Compu-Link generated it. FF 250. Grant Thornton's Project Manager admitted that she never saw the trial balance (a voluminous document) associated with this letter, and she did not ask anyone for the trial balance that was supposedly attached. FF 248–249. Finally, the Comptroller properly found, based upon the evidence of record, that the methodology the Project Manager employed for the second test[14] did 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.

For all these reasons, the Comptroller rejected the ALJ's conclusion that the "tests of reasonableness" used by Grant Thornton were "very strong" analytical procedures that could provide substantive evidence required by GAAS for a maximum risk audit as provided in Grant Thornton's audit manual.
FD 30-31.

B. Substantial Evidence Supports the Comptroller's Conclusion That Grant Thornton Acted Recklessly

The Comptroller concluded that Grant Thornton acted recklessly in its audit of Keystone's 1998 financial statements because it ignored the requirements of GAAS in the planning, supervising, and executing its audit

[14] To compute annual income, Grant Thornton took the income from the purported remittance and multiplied it by 12, even though the assets held by Keystone, and the interest the bank earned, would have fluctuated dramatically throughout the year as securitizations were completed. FD 35, FF 245.

involving essential financial statement entries in circumstances where it had acknowledged that the audit posed maximum risk ***and*** where red flags were clearly evident. As a result, Grant Thornton acted with disregard of and conscious indifference to the risk of substantial harm to those entitled to rely on its unqualified opinion that Keystone's 1998 financial statements were not materially misstated. In reaching his conclusion, the Comptroller recognized that auditors are not insurers and their reports do not constitute a guarantee. FD 2. For this reason, auditors are not sanctioned under FIRREA for simple noncompliance with the technical requirements of GAAS, or failing to detect fraud or misstatements. FD 2, 36. Rather, as the substantial evidence demonstrates here, it is only where the auditor, with respect to the most material entries on the insured depository institution's financial statements and in the context of a "maximum" risk audit, fails to employ staightforward and simple GAAS procedures that the auditor's unsafe or unsound practices rise to the level of recklessness. FF 36-37. "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." FD 37. Thus, the Comptroller properly rejected the ALJ's conclusion that Grant Thornton was not reckless because Keystone's management was engaged in fraud. FD 37.

The Comptroller found that Grant Thornton recklessly failed to comply with GAAS by not conducting a "Comprehensive" audit with a test of details (FD 38–39), by relying on a conversation to confirm the assets owned by Keystone (FD 39–40), by its use of non-substantive analytical procedures to verify Keystone interest income (FF 40–41), and by ignoring its obligation to understand Keystone's securitization process (FF 41–42). The Comptroller's Decision shows that three circumstances made Grant Thornton's failure to follow GAAS reckless. First, Grant Thornton knew that the audit presented a maximum risk that the financial statements were materially misstated. Second, Grant Thornton failed to follow GAAS's heightened professional skepticism procedures required in a high-risk audit with respect to the two most material items in the financial statements: (1) total assets of approximately $500 million reported on the balance sheet as owned by Keystone and serviced by third-party asset servers; and (2) interest income of $98 million from owned assets reported on the income statement. And, third, the procedures required to fulfill GAAS were simple and straightforward – obtain written confirmations of assets serviced by others and review the monthly remittances of income from asset servicers and check the general ledger to assure that the income was entered on the bank's books. The required procedures were not time consuming or complicated, nor otherwise impractical.[15] *Cf. Marrie v. SEC,* 374 F.3d at 1206 (recklessness under the SEC enforcement regime occurs "when an auditor 'skips procedures designed to test a company's reports or looks the other way despite suspicions.'").

In short, in the context of the circumstances surrounding the Keystone audit, the failure to follow simple GAAS procedures with regard to the two most material entries on the financial statements when conducting a high-risk audit ("maximum" risk in Grant Thornton's words) is reckless. Though unnecessary to establish that conduct is reckless, reckless behavior is often accompanied by evidence supporting the conclusion that the actor was consciously indifferent to the known or obvious risk. *Cavallari*, OCC-AA-EC-92-115 at 10. This is such a case. Grant Thornton demonstrated its indifference to the risk of harm to users

[15] Accordingly, Grant Thornton's citation (GT Br. at 44, 47) of Judge Randolph's observation in *Checkosky v. SEC*, 23 F.3d 452, 479 (D.C. Cir. 1994), that GAAS is not "a simple code" has no resonance here.

of Keystone's financial statements by its failure to comply with GAAS in completing the Keystone audit given the circumstances known to it.[16]

1. Grant Thornton's Reckless Failure to Amend its Audit Plan

In spite of overwhelming evidence that the bank's management, accounting data, and internal controls were unreliable, Grant Thornton initially assessed the risk of material misstatements in the Keystone financial statements at something below the "maximum" and planned a "Basic" audit. The initial plan called for Grant Thornton to verify Keystone's $98 million in reported interest income using a "test of reasonableness" based on financial information provided by Keystone, even though Grant Thornton: (1) did not plan to test the bank's internal controls for reliability; (2) knew that Keystone's internal control function was poor to non-existent; (3) knew Keystone's accounting records were unreliable; and (4) did not plan to independently verify the accuracy of the

[16] Throughout these proceedings, Grant Thornton has pointed to the involvement of OCC examiners at Keystone in an effort to excuse its conduct. No conduct by OCC examiners prevented Grant Thornton from performing any of the actions necessary to comply with GAAS. For example, Grant Thornton points out that bank examiners reviewed Grant Thornton's workpapers and did not cite Grant Thornton for violating GAAS. GT Br. at 36. But the examiners reviewed the work papers to prepare for the next examination of Keystone, not to assess Grant Thornton's compliance with GAAS. ALJ FF at ¶ 103. As already discussed, examiners rely upon audited financial statements in assessing the safety and soundness of depository institutions.

income figures to be provided by management. When other Grant Thornton auditors later determined that the audit had to be assessed as one involving a "maximum" risk of material misstatements, the assessment of audit risk was changed to "maximum." However, the audit plan itself was ***never amended*** and Grant Thornton proceeded to conduct its "Basic" audit. The failure to amend the Keystone audit plan to implement the heightened professional skepticism required in a high-risk audit demonstrates Grant Thornton's indifference to the substantial risk of harm from failing to comply with GAAS.

2. Grant Thornton's Reckless Reliance on an Oral Confirmation

Substantial evidence supports the Comptroller's conclusion that Grant Thornton's confirmation of approximately 25 percent of Keystone's assets, purportedly serviced by Advanta, was reckless, when, in the context of a "maximum" risk audit, Grant Thornton relied upon a purported oral confirmation to verify Keystone's ownership of the loans in the face of written evidence that directly conflicted that oral confirmation. The Comptroller found that Grant Thornton's actions were particularly egregious because: (1) 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 $6.3 million in Keystone loans; and (2) the oral evidence that Advanta was servicing an additional $236 million in Keystone loans upon which Grant Thornton purportedly relied was unambiguously contradicted almost immediately by the Project Manager's receipt of an e-mail from the Advanta representative with whom she had just spoken. The e-mail stated flatly that "Investor No. 406" held $236 million in loans and the "Investor" was ***United***. FF 203. Despite this discrepancy and the importance of this confirmation to the audit, no request for clarification (written or oral) was made.

By relying on the oral confirmation, Grant Thornton recklessly ignored the clear requirements of GAAS, and showed its indifference to the obvious risk of substantial harm that could result to those who relied on Grant Thornton's unqualified opinion that Keystone's financial statements were audited in accordance with GAAS and contained no material misstatements.

3. Grant Thornton's Reckless Audit of Reported Interest Income

Substantial evidence supports the Comptroller's conclusion that Grant Thornton recklessly failed to confirm the interest income being reported by Keystone. GAAS requires that in a high-risk audit an auditor perform a "test of details" in auditing both reported assets and reported income unless a "test of details" would be ineffective or inefficient. FF 220, 228; Tr. 2722– 2726 (Potter). Here, a "test of details" simply meant that Grant Thornton would need to review the monthly remittances from third-party asset servicers that were readily available at the bank (and at the asset servicers), then trace the income into the bank's general ledger account. FF 220–227. Yet, Grant Thornton made no attempt to review the remittances or trace reported income into the bank's accounts until months after the audit and just before the OCC placed the bank in receivership. Instead, Grant Thornton relied on two "tests of reasonableness," the first of which was so obviously flawed that even the Project Manager who was assigned to verify Keystone's income recognized that it was insufficient to satisfy GAAS, and the second of which obviously failed to comply with GAAS requirements to obtain appropriate evidence to support audit conclusions.

Underlying both tests' failure to comply with GAAS was Grant Thornton's failure to verify the financial information on which the tests were based. Thus, even if it had been appropriate under GAAS to rely on "tests of reasonableness" as substantive tests in confirming Keystone's income in the high-risk audit Grant Thornton was to conduct, Grant Thornton recklessly relied on obviously inadequate information in conducting the tests. In the first test, Grant Thornton relied on an insider-prepared schedule that Grant Thornton knew contained inaccurate data. In the second test, Grant Thornton again relied on documents provided by Keystone. In neither case, did Grant Thornton test the data or test the bank's internal controls to confirm that it could rely on the data. Again, Grant Thornton ignored the obvious risk of substantial harm to users of Keystone's financial statements from Grant Thornton's unqualified opinion that it had obtained reasonable assurance that the financial statements were not materially misstated while blatantly failing to comply with the requirements of GAAS.

Grant Thornton (GT Br. at 45 n.16 (citing FD 32 n.22)) asserts that the Comptroller misunderstood Grant Thornton's control-risk assessment procedures in concluding Grant Thornton would need to test Keystone's internal controls before relying on bank-generated data in conducting substantive analytical procedures. Grant Thornton instructed its auditors to:

> Assess control risk at the maximum (MAX) where no reliance will be placed on controls. In many of the Firm's audits, it may be more efficient to obtain sufficient competent evidential matter from substantive tests than to perform tests of controls [on the entity's internal control systems] to reduce our assessment of control risk.

OCC Ex. 296 at GT/F 00529. To be consistent with GAAS, this statement must mean that tests based upon internally generated data could not be used as substantive evidence *unless* the internal controls were tested by the auditors for reliability, but that it may be more efficient to obtain sufficient evidential matter using substantive tests (*i.e.* "tests of details") in some cases rather than analyzing the company's internal controls. *See* OCC Ex. 781 (AU 329.16) (an auditor must assess reliability of data for use in an analytical test based upon "[w]hether the data was developed under a reliable system with adequate controls" and upon "[w]hether the data was subjected to audit testing in the current or prior year"). Nevertheless, as further evidence of Grant Thornton's disregard of a known or obvious substantial risk of harm to users of its audit, and demonstrating its conscious indifference to that risk, Grant Thornton failed to assess the control risk at the MAX, even though it did not test Keystone's internal controls for reliability and did not test data generated internally by Keystone for accuracy, yet based its unqualified opinion on tests using that data.

4. Grant Thornton's Reckless Failure to Understand Keystone's Securitization Program

Substantial evidence also supports the Comptroller's conclusion that Grant Thornton recklessly failed to gain a sufficient understanding of Keystone's securitization business in planning and conducting the audit. Consistent with GAAS, Grant Thornton's audit manual stated that knowledge of the client's business was "critical" and "key." FF 116. Despite its importance, Grant Thornton's Project Manager, who was assigned to asset and income verification, testified that she did not believe that an understanding of Keystone's securitizations was important because "that was Mr. Quay's [the Lead Auditor's] responsibility." FF 125. The Lead Auditor had an obligation under GAAS to supervise the Project Manager and to make her aware of the importance of Keystone's securitization process to her audit responsibilities, even if she, herself, did not think it was important. FF 24. However, the Lead Auditor also did not understand that United owned almost all of the loans being used in Keystone's 1998 securitizations, despite the fact that he participated in those securitizations in connection with the provision of non-audit services to the bank. FF 123.

Grant Thornton argues that it was not indifferent to the mechanics of the securitization program because it asked generally for documents related to the bank's operations and was not given any documents about the securitization program. GT Br. at 51. Grant Thornton knew that Keystone was involved in large securitizations that were a major part of its operations. Yet, Grant

Thornton claims that it met its obligation to understand Keystone's business citing a standard letter from the bank's counsel discussing claims that could affect the bank's financial condition, vague discussions with bank insiders and others, and a generic request for documents. Apart from these general requests, Grant Thornton cites no evidence that it particularly sought, was provided, or reviewed any agreements or other documents concerning Keystone's securitization program, choosing instead to rely on its knowledge gained from other sources. In the context of a high risk audit, this was reckless, and it evidenced Grant Thornton's conscious indifference to the risk of harm that would flow from its unqualified opinion concerning the accuracy of Keystone's financial statements, harm that was ultimately realized.

VI. THE COMPTROLLER PROPERLY IMPOSED A C&D ORDER AND ASSESSED A $300,000 CMP AGAINST GRANT THORNTON

A. The Comptroller's Cease and Desist Order

FIRREA authorizes the Comptroller to issue a notice of charges for a cease and desist order directed to an IAP conducting the business of a national bank. 12 U.S.C. § 1818(b)(1). As explained above, substantial evidence supports the Comptroller's conclusion that Grant Thornton acted recklessly in conducting the business of Keystone because Grant Thornton was engaged to provide audit services necessary to Keystone's business operations.

Grant Thornton contends that the C&D Order serves no genuine remedial purposes and, therefore, is inappropriately punitive. GT Br. at 24. The courts normally will not disturb the enforcement remedies of a federal banking agency unless the agency abuses its discretion or otherwise acts arbitrarily and capriciously. *First Nat'l Bank of Bellaire v. Comptroller of the Currency,* 697 F.2d at 686. So long as substantial evidence exists to support the violation, the courts look only to determine if there is an articulated correlation between the action taken and the reason given for action.

The Comptroller has discretion to fashion relief in such form as to prevent future abuses. The C&D Order only applies to Grant Thornton's audits of insured depository institutions and seeks to assure that Grant Thornton has procedures in place to follow faithfully GAAS requirements. In fact, the C&D Order tracks, in many respects, the OTS Order that Grant Thornton was operating under at the time the Keystone audit took place and which expired in 2001. It is tailored to address the deficiencies identified in Grant Thornton's audit of Keystone and contains articles designed to assure that Grant Thornton complies in future depository institution audits with professional auditing standards including those mandating the exercise of professional due care and skepticism, and to assure that Grant Thornton maintains appropriate records to assess its conduct.

B. **The Comptroller's Decision to Assess a $300,000 CMP**

FIRREA authorizes the Comptroller to assess a second-tier CMP of not more than $25,000 per day against an IAP that "recklessly engages in an unsafe or unsound practice in conducting the affairs of [a national bank]." 12 U.S.C. § 1818(i)(2)(B). For the reasons set forth above, Grant Thornton recklessly engaged in an unsafe or unsound practice in conducting its audit of Keystone's 1998 financial statements. Grant Thornton's recklessly unsafe or unsound conduct was undertaken in conducting the affairs of Keystone because it was a requirement of federal law that Keystone obtain audited financial statements and Grant Thornton was engaged to perform that audit.

The $300,000 CMP, the amount of which is not challenged by Grant Thornton, is appropriate and based on the Comptroller's consideration of the appropriate mitigating factors. 12 U.S.C. § 1818(i)(2)(G).

CONCLUSION

For all of the foregoing reasons, the Comptroller's Decision, C&D Order, and CMP Order should be affirmed.

Respectfully submitted,

JULIE L. WILLIAMS

First Senior Deputy Comptroller
and Chief Counsel

DANIEL P. STIPANO
Deputy Chief Counsel

HORACE G. SNEED
Director of Litigation

ELLEN M. WARWICK
Assistant Director of Litigation

____
JEROME A. MADDEN
Counsel
(DC Bar 272260)

Office of the Comptroller
of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Telephone: (202) 874-5280
Facsimile: (202) 874-5279

July 25, 2007

FED. R. APP. P. 32(a)(7)(B)(i) CERTIFICATION

I, Jerome A. Madden, counsel of record for the Office of the Comptroller of the Currency, hereby certify that the foregoing brief contains 13,963 words. The brief is composed of Times New Roman 14 point typeface.

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JEROME A. MADDEN

ADDENDUM: STATUTES

Addendum

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5 U.S.C. § 706

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall--

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be--

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

12 U.S.C. § 1813(u)

(u) Institution-affiliated party

The term "institution-affiliated party" means--

(1) any director, officer, employee, or controlling stockholder (other than a bank holding company) of, or agent for, an insured depository institution;

(2) any other person who has filed or is required to file a change-in-control notice with the appropriate Federal banking agency under section 1817(j) of this title;

(3) any shareholder (other than a bank holding company), consultant, joint venture partner, and any other person as determined by the appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and

(4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in--

(A) any violation of any law or regulation;

(B) any breach of fiduciary duty; or

(C) any unsafe or unsound practice,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.

12 U.S.C. § 1818(b)(1)

(1) If, in the opinion of the appropriate Federal banking agency, any insured depository institution, depository institution which has insured deposits, or any institution-affiliated party is engaging or has engaged, or the agency has reasonable cause to believe that the depository institution or any institution-affiliated party is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated, or the agency has reasonable cause to believe that the depository institution or any institution-affiliated party is about to violate, a law, rule, or regulation, or any condition imposed in writing by a Federal banking agency in connection with any action on any application, notice, or other request by the depository institution or institution-affiliated party, or any written agreement entered into with the agency, the appropriate Federal banking agency for the depository institution may issue and serve upon the depository institution or such party a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the depository institution or the institution-affiliated party. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the agency at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the depository institution or the institution-affiliated party an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the depository institution or its institution-affiliated parties to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

12 U.S.C. § 1818(i)(2)(B)(II)

(i) Jurisdiction and enforcement; penalty

(2) Civil Money Penalty

* * *

(B) Second tier

Notwithstanding subparagraph (A), any insured depository institution which, and any institution-affiliated party who–

* * *

(II) recklessly engages in an unsafe or unsound practice in conducting the affairs of such insured depository institution;

* * *

shall forfeit and pay a civil penalty of not more than $25,000 for each day during which such violation, practice, or breach continues.

12 U.S.C. § 1818(i)(2)(G)

(G) Mitigating factors

In determining the amount of any penalty imposed under subparagraph (A), (B), or (C), the appropriate agency shall take into account the appropriateness of the penalty with respect to–

(i) the size of financial resources and good faith of the insured depository institution or other person charged;

(ii) the gravity of the violation;

(iii) the history of previous violations; and

(iv) such other matters as justice may require.

12 U.S.C. § 1831m

(a) Annual report on financial condition and management

(1) Report required

Each insured depository institution shall submit an annual report to the Corporation, the appropriate Federal banking agency, and any appropriate State bank supervisor (including any State bank supervisor of a host State).

(2) Contents of report

Any annual report required under paragraph (1) shall contain--

(A) the information required to be provided by--

(i) the institution's management under subsection (b) of this section; and

(ii) an independent public accountant under subsections (c) and (d) of this section; and

(B) such other information as the Corporation and the appropriate Federal banking agency may determine to be necessary to assess the financial condition and management of the institution.

(3) Public availability

Any annual report required under paragraph (1) shall be available for public inspection. Notwithstanding the preceding sentence, the Corporation and the appropriate Federal banking agencies may designate certain information as privileged and confidential and not available to the public.

* * *

(d) Annual independent audits of financial statements

(1) Audits required

The Corporation, in consultation with the appropriate Federal banking agencies, shall prescribe regulations requiring that each insured depository institution shall have an annual independent audit made of the institution's financial statements by an independent public accountant in accordance with generally accepted auditing standards and section 1831n of this title.

(2) Scope of audit

In connection with any audit under this subsection, the independent public accountant shall determine and report whether the financial statements of the institution--

(A) are presented fairly in accordance with generally accepted accounting principles; and

(B) comply with such other disclosure requirements as the Corporation and the appropriate Federal banking agency may prescribe.

* * *

(f) Form and content of reports and auditing standards

(1) In general

The scope of each report by an independent public accountant pursuant to this section, and the procedures followed in preparing such report, shall meet or exceed the scope and procedures required by generally accepted auditing standards and other applicable standards recognized by the Corporation.

* * *

(g) Improved accountability

* * *

(4) Enforcement actions

(A) In general

In addition to any authority contained in section 1818 of this title, the Corporation or an appropriate Federal banking agency may remove, suspend, or bar an independent public accountant, upon a showing of good cause, from performing audit services required by this section.

(B) Joint rulemaking

The appropriate Federal banking agencies shall jointly issue rules of practice to implement this paragraph.

(5) Notice by accountant of termination of services

Any independent public accountant performing an audit under this section who subsequently ceases to be the accountant for the institution shall promptly notify the Corporation and each appropriate Federal banking agency pursuant to such rules as the Corporation and each appropriate Federal banking agency shall prescribe.

(h) Exchange of reports and information

(1) Report to the independent auditor

(A) In general

Each insured depository institution which has engaged the services of an independent auditor to audit such institution shall transmit to the auditor a copy of the most recent report of condition made by the institution (pursuant to this chapter or any other provision of law) and a copy of the most recent report of examination received by the institution.

(B) Additional information

In addition to the copies of the reports required to be provided under subparagraph (A), each insured depository institution shall provide the auditor with--

(i) a copy of any supervisory memorandum of understanding with such institution and any written agreement between such institution and any appropriate Federal banking agency or any appropriate State bank supervisor which is in effect during the period covered y the audit; and

(ii) a report of--

(I) any action initiated or taken by the appropriate Federal banking agency or the Corporation during such period under subsection (a),(b), (c), (e), (g), (i), (s), or (t) of section 1818 of this title;

(II) any action taken by any appropriate State bank supervisor under State law which is similar to any action referred to in subclause (I); or

(III) any assessment of any civil money penalty under any other provision of law with respect to the institution or any institution-affiliated party.

(2) Reports to banking agencies

(A) Independent auditor reports

Each insured depository institution shall provide to the Corporation, any appropriate Federal banking agency, and any appropriate State bank supervisor, a copy of each audit report and any qualification to such report, any management letter, and any other report within 15 days of receipt of any such report, qualification, or letter from the institution's independent auditors.

(B) Notice of change of auditor

Each insured depository institution shall provide written notification to the Corporation, the appropriate Federal banking agency, and any appropriate State bank supervisor of the resignation or dismissal of the institution's independent auditor or the engagement of a new independent auditor by the institution, including a statement of the reasons for such change within 15 calendar days of the occurrence of the event.

* * *

12 U.S.C. 1831n

(a) In general

(1) Objectives

Accounting principles applicable to reports or statements required to be filed with Federal banking agencies by insured depository institutions should--

(A) result in financial statements and reports of condition that accurately reflect the capital of such institutions;

(B) facilitate effective supervision of the institutions; and

(C) facilitate prompt corrective action to resolve the institutions at the least cost to the Deposit Insurance Fund.

(2) Standards

(A) Uniform accounting principles consistent with GAAP

Subject to the requirements of this chapter and any other provision of Federal law, the accounting principles applicable to reports or statements required to be filed with Federal banking agencies by all insured depository institutions shall be uniform and consistent with generally accepted accounting principles.

(B) Stringency

If the appropriate Federal banking agency or the Corporation determines that the application of any generally accepted accounting principle to any insured depository institution is inconsistent with the objectives described in paragraph (1), the agency or the Corporation may, with respect to reports or statements required to be filed with such agency or

Corporation, prescribe an accounting principle which is applicable to such institutions which is no less stringent than generally accepted accounting principles.

* * *

CERTIFICATE OF SERVICE

I, DeGeta Cole, hereby certify that on July 25, 2007, I caused to be delivered by U.S. Mail two true and correct proof copies of the Office of the Comptroller of the Currency's Responsive Brief upon counsel for Petitioner at the following address:

Mr. Mark W. Ryan
Mr. Andrew J. Morris
Ms. Miriam R. Nemetz
MAYER, BROWN, ROWE & MAW LLP
1909 K Street, N.W.
Washington, D.C. 20006

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DeGeta Cole