



Public Company Accounting Oversight Board

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

In the Matter of Cordovano and Honeck LLP
and Samuel D. Cordovano, CPA,

Respondents.

PCAOB No. 105-2010-004

Hearing Officer – DMF

INITIAL DECISION

July 6, 2011

Summary

Respondent Samuel D. Cordovano, CPA, violated Section 105(c)(7)(A) of the Sarbanes-Oxley Act of 2002 (Act) and PCAOB Rules 5000 and 5301(a) by willfully becoming or remaining an associated person of a registered public accounting firm after being barred from such association, and Respondent Cordovano and Honeck LLP (Firm) violated Section 105(c)(7)(A) of the Act and PCAOB Rules 5000 and 5301(b) by permitting Respondent Cordovano to become or remain an associated person of the Firm when it knew that Cordovano was barred from such association. For these violations, both of which resulted from intentional or knowing conduct, including reckless conduct, Respondent Cordovano is permanently barred from association with any registered public accounting and Respondent Firm's PCAOB registration is permanently revoked.

DECISION

I. Introduction

The Board issued the Order Instituting Disciplinary Proceedings (OIP) in this matter on November 5, 2010. The OIP alleged that, after the Board issued a consent order barring Respondent Samuel D. Cordovano, CPA (Cordovano), from being an associated person of a registered public accounting firm on December 18, 2008 (the 2008

Order),¹ Cordovano engaged in certain specified activities, in connection with the audits of four issuers performed by Respondent Cordovano and Honeck LLP (Firm), that caused him to be an associated person of the Firm. The OIP charges that Cordovano thereby violated Section 105(c)(7)(A) of the Sarbanes-Oxley Act of 2002 (the Act), and PCAOB Rules 5301(a) and 5000, and that the Firm thereby violated Section 105(c)(7)(A) of the Act and Rule 5301(b).

On November 29, 2010, Respondents filed an Answer to the OIP in which they admitted some factual allegations, denied other factual allegations, and denied that they had violated the Act or PCAOB rules, as charged. An evidentiary hearing was held in Denver, Colorado, from March 7 through March 11, 2011. At the hearing, the Division of Enforcement and Investigations (Division) called three witnesses: Heather Zhou and Christine Quijote-Oakes, both former Firm employees, and Richard Fleischman, a CPA partner in another registered public accounting firm, who the Firm retained to serve as the independent reviewer for one of the relevant audits. Respondents called five witnesses: Cordovano; Cole Honeck, co-owner of the Firm; Jeffrey Ginsburg, a former Firm employee; Marcel Noordeloos, the former CFO of one of the relevant issuers; and Mickie Koslofsky, the former CFO of another of the relevant issuers. In addition, the Division and Respondents each offered a substantial number of exhibits—primarily contemporaneous emails and other documents—and the parties offered the 2008 Order and two sets of stipulations as joint exhibits.

Following the hearing, the Division filed its post-hearing submission on April 21, 2011 and Respondents filed their post-hearing submission on May 24, 2011. On May 25,

¹ See In the Matter of Cordovano and Honeck, P.C. and Samuel D. Cordovano, CPA, PCAOB Release No. 105-2008-004 (Dec. 18, 2008).

2011, the Division notified the Hearing Office that it would not file a reply to Respondents' post-hearing submission.²

II. Facts

A. Background

Cordovano, who is 63 years old, moved to Colorado and qualified as a CPA after graduating from college. He worked as an auditor for the federal government for five years, worked for two years in a CPA firm, and, after that firm disbanded, established the predecessor of the Firm as a sole proprietorship in 1986. Cordovano hired Cole Honeck as a junior accountant in 1993, after Honeck graduated from college. Honeck obtained his CPA license in Colorado in 1995. At that time, the Firm consisted of just Cordovano, as owner, and Honeck, as his only employee. Tr. 523-24, 526, 869.

In approximately 1997 or 1998, Cordovano formed a partnership with another CPA, who assumed a 50% ownership in the Firm. That partnership continued until 2002, when the other CPA left the partnership, and Honeck purchased her 50% share of the business. Cordovano and Honeck held equal shares of the Firm until early 2010, when Colorado suspended Cordovano's CPA license, based on the 2008 Order. To comply with Colorado rules requiring that CPAs hold a majority interest in CPA firms, Honeck became a 51% owner of the Firm, and Cordovano's ownership share decreased to 49%. Cordovano and Honeck continued to hold those interests in the Firm as of the date of the hearing.³ Tr. 525-27, 869-72; J-2 at ¶ 2.

² In this Initial Decision, "Tr." refers to the hearing transcript; "D-" refers to the Division's exhibits in evidence; "R-" refers to Respondents' exhibits in evidence; "J-" refers to the parties' joint exhibits; "DPS" refers to the Division's post-hearing submission; and "RPS" refers to Respondents' post-hearing submission.

³ Respondents' post-hearing submission asserts that following the hearing, Cordovano left the Firm and assumed a position as the president of a Denver-area company. RPS at 2 n.2, 28.

Although Cordovano and Honeck were equal partners from 2002 until 2010, they did not have equal responsibilities for the operation of the Firm. Cordovano was the managing partner, and had responsibility for employment and regulatory issues, quality control, and “generally had final say on any significant transactions,” while Honeck was in charge of the Firm’s accounting and bookkeeping, payroll, and assisted the Firm’s outside accountant in preparing the Firm’s tax returns. Tr. 528, 873-74.

B. The 2008 Order

The Firm has been a registered public accounting firm since at least 2004. In 2004, the PCAOB conducted an inspection of the Firm. Thereafter, the Division began an investigation, which culminated in the 2008 Order. Tr. 529-31.

Cordovano testified that he represented the Firm and himself during the investigation, without the assistance of counsel, until shortly before the 2008 Order was issued. During this period, he engaged in settlement discussions with the Division, leading to the Division “propos[ing] a one-year timeout just for [Cordovano] alone,” which Cordovano felt “would preserve the company.” Before the Order was issued, however, the Firm and Cordovano retained the same experienced and knowledgeable counsel who represented them in this proceeding, and “[u]ltimately after going over [the Division’s settlement proposal] with counsel, [Cordovano] decided to consent to the [2008 Order].” Tr. 531, 534-35.

Cordovano testified that in the course of his negotiations with the Division, he asked Division counsel to explain the implications of the 2008 Order in detail: “What can I do and what can’t I do?” Division counsel, however, “were unwilling to advise

[him].” Tr. 536. Nevertheless, represented by counsel, Cordovano and the Firm agreed to the 2008 Order.

The 2008 Order included findings that the Firm and Cordovano violated PCAOB rules and professional standards in various respects in connection with their audits of the FY 2003 and FY 2004 financial statements of one issuer and the FY 2004 financial statements of another issuer. Based on those violations, the Board censured the Firm and barred Cordovano from being “an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i),” with the proviso that Cordovano could file a petition for Board consent to associate with a registered public accounting firm after one year from the date the 2008 Order was issued, which was December 18, 2008.⁴ J-1 at 14. In the 2008 Order, the Board stated:

The sanctions that the Board is imposing on Cordovano in this Order may be imposed only if a respondent’s conduct meets one of the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5). The Board finds that Cordovano’s conduct described in this Order meets the condition set out in Section 105(c)(5), which provides that such sanctions may be imposed in the event of: (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

J-1 at 2 n.2; J-2 at ¶ 3.

After the 2008 Order was issued, the Division sent Respondents’ counsel a letter dated December 23, 2008. R-29; J-2 at ¶ 4. In the letter, the Division noted that Respondents had “asked the Division ... for guidance regarding the effects of the sanction entered against Mr. Cordovano” The letter explained that under the 2008 Order, Cordovano was “barred from being an associated person of a registered public

⁴ The Firm was known as Cordovano and Honeck, P.C. at the time of the 2008 Order. J-2 at ¶ 1.

accounting firm, as that term is defined in Section 2(a)(9) of the [Act],” but that Cordovano could apply for Board consent to associate with a registered public accounting firm after one year. The letter stated that “the staff cannot provide legal advice or advise whether any particular future conduct by Mr. Cordovano, the Firm, or any other person would be consistent with PCAOB Rules or Standards or with a bar,” but offered a general description of the provisions of Rule 5301 addressing the effects of a bar. R-29 at 1.

The letter noted that the 2008 Order did “not necessarily preclude Mr. Cordovano from continuing to be a partner in the Firm.” Citing the Note to Rule 5301(a), however, the letter explained that a “person [who is] suspended or barred from being associated with a registered public accounting firm may not, in connection with the preparation or issuance of any audit report, (i) share in the profits of, or receive compensation in any other form from, any registered public accounting firm, or (ii) participate as agent on behalf of such a firm in any activity of that firm.” *Id.* at 2 (emphasis in Division’s letter).

C. Respondents’ Actions in Response to the 2008 Order

Cordovano testified that, based on the Division’s letter, he understood that “the order did not affect my ownership of the company. I could continue to be a partner in the company with all that[] responsibility, and what that entails.” Cordovano further testified that after reading the Division’s letter, he did not have a clear understanding of the specific activities that were prohibited, and therefore drew his own conclusions in that regard. He concluded that he “was barred from participating in an audit of an issuer for a one-year period.” Cordovano believed that, among other things, he “couldn’t prepare work papers or review them,” and he “determined not to charge SEC clients for any of [his] services, whether they were in connection with an audit or not.” Tr. 537-41.

Honeck testified that he was not involved in the negotiations leading to the 2008 Order, but that Cordovano told him “that he had agreed to accept the bar as part of the negotiation to try to maintain the firm’s ability to continue conducting public company audits.” He testified that he and Cordovano “had a general understanding that Mr. Cordovano was not to be involved in audits of public clients, but we didn’t—we weren’t really sure how the details of that sanction applied.” Nevertheless, he testified that he understood that Cordovano “could not be involved in the audits of public companies and that Cordovano “should not be instructing the staff if it was related to performing a public company audit.” Tr. 877-78, 882, 906, 931.⁵

Honeck testified that the Firm held a general meeting of the Firm’s staff to discuss the impact of the bar. Tr. 884. Zhou, however, testified that she was not aware of any such meeting, and Cordovano agreed, testifying that, instead, he “told each staff member [of the Firm] at the time and place of [his] choosing about the bar.” Tr. 38, 556. In any event, it was undisputed that the Firm did not establish any written policies or directives concerning compliance with the bar. Tr. 39, 920; D-114 at 6.

“As their primary response to the bar, Respondents hired Heather Zhou to handle Mr. Cordovano’s public company clients.” RPS at 1. Zhou was born and educated in China. She moved to the United States in 2000, and studied at the University of Denver, where she received a masters degree in accounting in 2002 and a masters degree in finance in 2005. She passed her Colorado CPA examination in 2002, and obtained her CPA license after she received her accounting degree. Tr. 23-25.

⁵ Both Cordovano and Honeck indicated that Respondents may have consulted their counsel regarding the scope of the bar, but neither witness described any advice they received, and Respondents did not assert reliance on advice of counsel as either a defense to the charges or in mitigation of sanctions. Tr. 852, 882. See, e.g., Leslie A. Arouh, Exch. Act Rel. No. 62898, 2010 SEC LEXIS 2977, at *52 (Sept. 13, 2010). Apart from the Division’s letter and any unspecified advice Respondents may have received from counsel, Cordovano testified that he did not seek advice from any other source regarding the scope of the bar.

From 2002 until she joined the Firm in October 2008, Zhou held a series of jobs in which she worked as an in-house accountant for various businesses. Prior to joining the Firm, Zhou had never served as an auditor, at any level of responsibility, on an audit of an issuer. Indeed, although she had worked with outside auditors in one of her in-house positions, there is no evidence that she had ever been an independent auditor, at any level of responsibility, on an audit of any type of entity, public or private, prior to her employment with the Firm. Tr. 25-26, 30, 980.

The Firm hired Zhou as a senior manager while Cordovano was negotiating with the Division, but before the 2008 Order was issued. Zhou testified that the Firm initially offered her a senior accountant position, but she negotiated a senior manager position. Both Cordovano and Honeck, however, testified that when the Firm hired Zhou, they anticipated that she would function as an engagement partner on audits of issuers after the 2008 Order became effective. Tr. 28, 549-50, 980-81.

The Firm promoted Zhou to the position of non-equity engagement partner in January 2009. Zhou testified that she was concerned about her ability to function as an engagement partner when she was promoted, but Cordovano told her that he would train her. After promoting Zhou, the Firm assigned her to be the engagement partner for the Firm's audits of the 2008 financial statements of several issuers, including three of the four audits at issue in this proceeding. Zhou replaced Cordovano as the engagement partner for all three audits. Tr. 34, 36, 551, 898.

D. The Audits at Issue

The OIP alleges that Cordovano was an associated person of the Firm because he engaged in certain specified activities in connection with the Firm's audits of the FY

2008 financial statements of four issuers: China Solar & Clean Energy Solutions, Inc. (China Solar), Playlogic Entertainment, Inc. (Playlogic), ICOP Digital, Inc. (ICOP), and Tombstone Technologies, Inc. (Tombstone).

1. The China Solar Audit

At the relevant time, China Solar was a China-based manufacturer and distributor of heating devices, and was an issuer, as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). On April 15, 2009, the Firm issued an audit report expressing an unqualified opinion on China Solar's FY 2008 financial statements that was included in China Solar's Form 10-K filed with the SEC. J-2 at ¶¶ 25-27.

The OIP alleges: "Cordovano participated in substantive audit decisions in connection with the preparation and issuance of the Firm's audit report for China Solar in the following ways:

- a. Cordovano analyzed equity purchase agreements involving China Solar, and researched how China Solar should appropriately record the equity purchases in the Company's 2008 financial statements;
- b. Cordovano relayed his analysis on the proper accounting treatment for the equity purchase agreements to Firm staff working on the China Solar audit, upon which [F]irm staff relied in performing audit procedures; and
- c. Cordovano provided guidance to Firm staff on the identification and disclosure of a material weakness in China Solar's internal controls over financial reporting." OIP ¶ 14.

Cordovano had been the engagement partner for the Firm's audit of China Solar's FY 2007 financial statements, prior to the issuance of the 2008 Order. J-2 at 5. He

testified that one of the reasons the Firm hired Zhou was the hope that she would be of assistance to the Firm in developing its auditing practice for issuers located in China. In December 2008, Cordovano and Zhou traveled to China, in part to introduce Zhou to the management of China Solar and the members of a Chinese accounting firm with which the Firm had a business relationship. Tr. 31-33.

In January 2009, Zhou was assigned to serve as the Firm's engagement partner for the audit of China Solar's FY 2008 financial statements. J-2 at ¶ 6. In February 2009, Zhou traveled to China to oversee the audit field work, which was performed with the assistance of accountants from a Chinese accounting firm, working under her direction. Tr. 62, 182. During the field work, she sought Cordovano's input on two issues.

The first issue concerned China Solar's accounting for an acquisition during 2008—specifically, whether the acquired company's financial statements could be consolidated into China Solar's financial statements. Tr. 63-68. On February 27, 2009, Zhou sent Cordovano an email with an attached memo concerning that issue. Tr. 183; D-14 at 2.⁶ On the same day, Cordovano responded with an email in which he indicated that he would “analyze the equity purchase agreements” to determine the appropriate accounting treatment. Cordovano attached to his email “an analysis of a similar issue” that he had prepared for another Firm issuer client, prior to the bar. He stated that he would “use a similar format (clause-by-clause comparison of agreements with [Emerging Issues Task Force (EITF) Issue No.] 96-16),”⁷ and asserted: “If it turns out that [China Solar] does not control [the subsidiary], the agreements will need to be amended.” D-14

⁶ The Division's exhibit D-14 includes the text of Zhou's February 27, 2009, email to Cordovano, which refers to an attached memo regarding the acquisition issue, but not the memo itself.

⁷ EITF Issue No. 96-16 addresses “Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights.”

at 1, 3-7. On the following day, February 28, Cordovano sent Zhou another email confirming that he planned “to compare the acquisition agreements with EITF 96-16, to ensure that [China Solar] is able to consolidate under [generally accepted accounting principles (GAAP)].” D-16 at 2.

Zhou testified that she recalled Cordovano preparing a checklist “with different questions related to the consolidation, the acquisition,” the purpose of which was to determine if “China Solar [had] control of the subsidiary and [could] consolidate this subsidiary into the financial statements of China Solar.” Tr. 68. No such checklist was offered in evidence, however, and Cordovano testified that he did not perform an analysis of China Solar’s equity purchase agreements, because he realized that “[s]uch an analysis might call into question my agreement with the [B]oard, my signature on the bar.” Tr. 663. He indicated that after he sent the February 27 email, in which he stated he would perform such an analysis, he reconsidered, and decided not to so, testifying: “I ... didn’t want to have any problems with my bar I didn’t think it was appropriate. Even though I first said I would do it.” Tr. 827-28, 831.

Nevertheless, Cordovano testified, he thought it was appropriate to send Zhou the analysis that he had performed for another Firm client, reasoning that China Solar’s acquisition occurred while he was the Firm’s engagement partner for China Solar; that “surely I had a duty to explain this information to Ms. Zhou since she was new”; and that he was “simply sending her a document from our library that she may or may not have been aware that [w]e had.” Tr. 663, 665. During his investigative testimony, however, Cordovano offered a somewhat different explanation, asserting that he “felt that [Zhou]

needed my help on this particular issue,” and explaining: “So I am gently—as I did with all my people, I gently led them down the path here.” D-114 at 14-15.

I conclude that Zhou’s testimony alone, without any supporting documentation, is insufficient to prove by a preponderance of the evidence that Cordovano followed through on his promise to analyze whether China Solar could consolidate the acquired firm’s financial statements in conformity with GAAP.⁸ On the other hand, I find that the Division did prove by a preponderance of the evidence that Cordovano received a request from Zhou for assistance in analyzing China Solar’s agreements; determined that the issue was similar to one he had analyzed for another client before the bar; and sent that analysis to Zhou, explaining that it would be necessary to conduct a similar analysis under EITF to determine if China Solar could consolidate the subsidiary’s financial statements, and what would be required if the analysis showed that China Solar did not have the required control over the subsidiary. To that degree, the evidence sustained the OIP’s allegations that “Cordovano analyzed equity purchase agreements involving China Solar, and researched how China Solar should appropriately record the equity purchases in the company’s 2008 financial statements” and that he “relayed his analysis on the proper accounting treatment for the equity purchase agreements to Firm staff working on the China Solar audit.” OIP ¶ 14.

The second issue that Zhou raised with Cordovano in her February 27, 2009, email was her belief that China Solar had failed to comply with a Chinese regulatory

⁸ I reject, however, Cordovano’s testimony that he did not perform the analysis because he concluded that it might violate the bar. In his February 27 email he not only sent Zhou his prior analysis, but also promised to perform a detailed “clause-by-clause comparison of [China Solar’s] agreements with EITF 96-16,” and he repeated his promise to perform such an analysis in another email on the following day. D-14 at 1; D-16 at 2. If Cordovano did not actually perform the analysis, it was because China Solar subsequently decided to rescind the acquisition transaction, so that, as Cordovano admitted, “ultimately [the accounting issue] did not go anywhere.” Tr. 831-32; see also D-114 at 15.

requirement in connection with the acquisition. Tr. 68-73. In his February 27 email response to Zhou, Cordovano stated:

We have a responsibility to report to the [China Solar] Board instances of noncompliance with laws and regulations. We will have to decide whether such noncompliance is “a significant deficiency” or “a material weakness.” Also, we should consider giving the client a reasonable period of time to correct the noncompliance, if one continues to exist. I can’t tell from your memo if the noncompliance is serious or just a formality. At some point the lawyers should be brought into the matter, as we lack the legal background to assess non-compliance with laws-but not quite yet.

D-14 at 1, 2.

In an email dated February 28, Zhou responded to Cordovano, expressing her view that “the noncompliance is ‘a material weakness,’” and explaining the reasons for her conclusion in that regard. D-16 at 3. On the same date, Cordovano replied to Zhou, advising her that the noncompliance issue “contains two distinct questions”: (1) whether China Solar’s management “agree[d] that the legal formalities [had] not been followed”; and (2) “[w]hat is our responsibility in a situation where we discover that [China Solar] has not complied with the terms of the acquisition agreement nor with China law?” With regard to the second question, Cordovano offered a definitive answer: “[W]e are to inform the Board. If the Board does nothing, then we are to resign.” Cordovano tempered this answer, however, by noting that “we normally would discuss the matter with [China Solar’s] lawyers before informing the Board, as we are not experts in these matters.” He instructed Zhou to “discuss this matter thoroughly” with China Solar’s management before returning to the United States, and to “be prepared to discuss the matter (and present evidence) to the lawyers” after her return. D-16 at 2.

On March 2, 2009, Zhou sent Cordovano an email in which she reported that she had discussed the issue with China Solar’s CEO, who “agree[d] that the legal formalities

[had] not been followed.” The CEO indicated that it would be difficult, if not impossible, to obtain the required approvals, and that he viewed the acquisition as “not a good deal,” and wanted to “pull out.” She reported that she would be meeting with China Solar’s management and its new attorneys to discuss how to address the noncompliance issue, “mostly to move back from the acquisition.” D-16 at 1-2. Cordovano responded on the same day with an email in which he praised Zhou for a “superb job”; observed that “the lawyers may propose a ‘rescission’ of the acquisition agreement”; and explained that, if a rescission occurred, “we must consult to determine how [China Solar] should account for it and report it,” listing a series of questions relevant to that issue. D-16 at 1.

Respondents “acknowledge that Cordovano agreed with Zhou’s analysis that the issue should be disclosed as a material weakness.” They assert, however, that “Zhou’s decision came first. Her testimony is that she made the decision, then communicated it to Cordovano at which point he agreed.” RPS at 21.

Cordovano, however, did not simply agree with Zhou’s material weakness conclusion. He analyzed the noncompliance issue for her, told her what the Firm’s obligations were as China Solar’s auditor, and directed her to consult with China Solar’s management regarding the issue. And when Zhou advised Cordovano that China Solar wanted to back out of the acquisition, once again he analyzed and explained the issue and the Firm’s obligations as China Solar’s auditor. All of his communications with Zhou addressed what “we” should or must do, and were instructive, rather than advisory, in tone. I find, therefore, that the Division proved by a preponderance of the evidence that Cordovano “provided guidance to Firm staff on the identification and disclosure of a

material weakness in China Solar's internal controls over financial reporting," as alleged in the OIP. OIP ¶ 14.

The OIP also alleges: "In July 2009, as a result of a Board inspection of the Firm's China Solar audit, the Firm became aware of certain audit procedures that had not been performed during the China Solar audit. Cordovano supervised Firm staff in their performance of these omitted audit procedures. The Firm billed China Solar for Cordovano's time supervising the performance of these procedures." OIP ¶ 15.

The parties stipulated that in June 2009, the PCAOB's Division of Registration and Inspections conducted an inspection of the Firm, focusing on six Firm audits, including the China Solar audit, and that, as a result of the inspection, the Firm became aware of certain audit procedures that had not been performed during the China Solar audit. J-2 at ¶¶ 8, 30.

In his direct testimony at the hearing, Cordovano did not address the allegation that he "supervised Firm staff in their performance of ... omitted audit procedures." During his investigative testimony, however, Cordovano testified that "the PCAOB inspection showed ... that our firm had omitted some procedures on the China Solar engagement. And I was responsible for complying with the PCAOB inspection. And I worked closely with the inspectors. And so I took it upon myself as not a violation of my bar to make sure that those omitted procedures got done." He explained that the omitted procedures included "five procedures related to percentage completion, auditing the even-and-even valuation, the pre-acquisition contingency accounting or auditing. ... And ... the impairment test on ... the goodwill." When asked "did you in fact ... supervise omitted procedures," Cordovano initially testified, "I did, yes," but

subsequently stated: “I didn’t supervise. I’m making sure that these procedures get done.” The Firm’s billing records indicate that Cordovano recorded time spent on this work, but that the Firm wrote off his time as “training.” D-114 at 15-16, 18-19.

The distinction that Cordovano attempted to draw, during his investigative testimony, between supervising the performance of the procedures and “making sure that these procedures get done” is not meaningful. I find, therefore, that the Division proved by a preponderance of the evidence that Cordovano supervised Firm staff in their performance of omitted audit procedures, as alleged in the OIP. On the other hand, the Division failed to prove that the Firm billed China Solar for Cordovano’s work; on the contrary, the Division concedes in its post-hearing submission that the Firm wrote off Cordovano’s time. DPS at 9.

Finally, the OIP alleges: “In June and July 2009, Cordovano participated in and supervised the performance of procedures related to the Firm’s issuance of a consent to include its previously issued audit opinion in a registration statement in a Form S-1 filing by China Solar pursuant to the Securities Act of 1933 in connection with the sale of securities by its security holders.” OIP ¶ 16.

In June 2009, after the issuance of the Firm’s audit report on China Solar’s 2008 financial statements, China Solar requested that the Firm provide a “consent to file” the audit report in connection with China Solar’s filing of an S-1 registration statement. Zhou advised China Solar that in order to provide such a consent, the Firm would have to perform some additional procedures. A debate ensued between China Solar’s management and Zhou, on behalf of the Firm, as to whether it was necessary and appropriate for the Firm to perform the additional work. On June 18, 2009, apparently

frustrated by Zhou's insistence that the additional work was required and the failure of the Firm to provide the requested consent, China Solar's management sent an email to Cordovano seeking his intervention. Tr. 74-84; D-57.

On June 16, 2009, shortly before China Solar contacted Cordovano, Zhou sent a memorandum to Cordovano "request[ing] [her] resignation as lead partner in this client, effective immediately." In her memorandum, Zhou stated that she "realized that the risks associated with this client require the involvement of an equity partner of [the Firm]," and that she "would like to work as a manager for this client" D-116. Consistent with this memorandum, Zhou testified that her role with regard to the requested consent was that of "accounting manager," and that her "understanding was that [Cordovano] led the work." Tr. 75.

Zhou testified that, after Cordovano received the email from China Solar, he discussed the issue with her and confirmed that the Firm required updated financial information from China Solar in order to provide the requested consent. On June 22, 2009, Cordovano sent an email to China Solar's CEO in which, inter alia, he advised the client that "[u]nder the provisions of Section 11 of the Securities Exchange Act, our Firm is charged with making a reasonable investigation up to the effective date of the registration statement as to whether the audited financial data to which the report relates contains any untrue statement of material fact or omits to state a material fact necessary in order to make the data not misleading." Cordovano attached the Firm's "Post Audit Review Procedures" and stated that he and Zhou would be happy to discuss the procedures with China Solar and its counsel. Notably, although Cordovano admitted that he composed and sent the email, he closed the email: "Sincerely, Cole Honeck." At the

hearing, he could not explain why he had signed Honeck's name to the email, indicating that it appeared to be a mistake. D-61; Tr. 80, 83-85, 672.

Respondents argue that Cordovano merely instructed Zhou to "manage the engagement so the consent is handled promptly and professionally"; reminded Zhou that she was "responsible for managing all aspects of the [China Solar] account"; and directed her to "consult with the partner in charge," who, Respondents assert, was Honeck. RPS at 23, quoting D-73.

The exhibit cited by Respondents, D-73, contains an exchange of emails between Cordovano and Zhou on July 13, 2009, concerning the Firm's procedures in connection with China Solar's Form S-1 consent request. As indicated above, by that date Zhou had resigned as the engagement partner for China Solar and was serving as the manager. According to the email exchange, Honeck had replaced Zhou as engagement partner. The July 13 email exchange, however, occurred after Cordovano's June 22 email to China Solar's CEO discussed above, and it does not obviate Cordovano's intervention in the Form S-1 consent issue as reflected in the June 22 email. Indeed, the July 13 email exchange shows Cordovano's continued involvement in the issuance of the consent.

I find, therefore, that the Division also proved by preponderance of the evidence that Cordovano participated in and supervised the performance of the Firm's procedures in connection with China Solar's request for consent to include the Firm's previously issued audit opinion in its Form S-1 filing, as alleged in the OIP.

2. The Playlogic Audit

Playlogic was a Netherlands-based publisher of video game software and other digital entertainment products. It was an issuer, as defined in Section 2(a)(7) of the Act

and PCAOB Rule 1001(i)(iii). On March 31, 2009, the Firm issued an audit report expressing an unqualified opinion on Playlogic's FY 2008 financial statements that was included in Playlogic's Form 10-K filed with the SEC. J-2 at ¶¶ 31-33.

The OIP alleges: "The Firm, through Cordovano, assigned the Non-Equity Partner to serve as the partner with final responsibility on the audit of Playlogic's 2008 financial statements. During the audit's initial stages, however, the Non-Equity Partner informed Cordovano that workload conflicts on other engagements prevented the completion of the engagement partner responsibilities on the Playlogic audit. Thereafter, with Cordovano's agreement, the Non-Equity Partner did not work on the Playlogic audit." OIP ¶ 17.

The OIP further alleges: "Instead of assigning another person to serve as the partner with final responsibility for the Playlogic 2008 audit, Cordovano filled in for the Non-Equity Partner and participated in the Playlogic 2008 audit in the following manner:

- a. Cordovano coordinated the Firm staff's completion of the audit;
- b. Cordovano reviewed the Management Discussion and Analysis section of Playlogic's 2008 Form 10-K and communicated his corrections to Firm staff;
- c. Cordovano traced the footnotes to the financial statements to other documentation; and
- d. Cordovano authorized the issuance of the audit report that was included in Playlogic's Form 10-K filing with the [SEC]"

OIP ¶ 18.

Cordovano had been the engagement partner for the Firm's audit of Playlogic's 2007 financial statements. In January 2009, Zhou was appointed to serve as the

engagement partner for the Firm's audit of Playlogic's 2008 financial statements. J-2 at ¶¶ 5-6; R-4. Zhou testified, however, that "soon after [she] was assigned as engagement partner," she concluded that her workload on other audits did not allow her to serve as the engagement partner on the Playlogic audit. She testified she discussed the issue with Cordovano, who told her, "don't worry about it. He would take care of it." Tr. 49.

There is no documentary evidence directly supporting Zhou's claim that Cordovano relieved her of responsibility for the Playlogic audit. On March 3, 2009, however, Zhou sent an email to Cordovano and Honeck setting out "a preliminary schedule for my clients on hand," which did not include the Playlogic audit. Cordovano responded to Zhou's email without indicating that she had omitted the Playlogic audit from her work schedule. D-130 at 1-2; Tr. 50-51. This email exchange provides indirect support for Zhou's claim.

On the other hand, Cordovano testified that Zhou remained as the engagement partner on the Playlogic audit to its conclusion. His testimony was supported, to a degree, by Quijote-Oakes, who served as the senior manager for the Playlogic audit from her home in Ohio. She testified that she understood that Zhou was the engagement partner for the Playlogic audit. Noordeloos, Playlogic's CFO, also testified that he understood that Zhou was the engagement partner for the audit, and that Zhou did not tell him during the audit that she was no longer the engagement partner. Cordovano's testimony is also supported by various documents in evidence, including emails that Cordovano sent to Quijote-Oakes and Noordeloos near the end of the audit in which he implied that Zhou remained the engagement partner. Tr. 389, 600, 1010-11; D-24; D-36; D-37.

I do not find, therefore, that the Division proved by a preponderance of the evidence that Zhou was formally replaced as the Playlogic engagement partner during the course of the audit. The evidence did establish, however, that Quijote-Oakes, who had worked on the Firm's audits of Playlogic's 2006 and 2007 financial statements, was primarily responsible for the Firm's audit of Playlogic's 2008 financial statements. She traveled to the Netherlands with Ginsburg to perform field work, and communicated with the local Netherlands-based accountants who assisted with the audit. Further, although Quijote-Oakes testified that she understood that Zhou was the engagement partner, she also testified that Cordovano, rather than Zhou, monitored her progress on the audit, and that she did not recall receiving any supervision from Zhou during the audit.⁹ Tr. 388-90, 1004-05, 1007. Her testimony is supported by several email exchanges, described below.

On March 31, 2009, there was a series of email communications leading up to the issuance of the Firm's audit report and the filing of Playlogic's Form 10-K that day.¹⁰ Quijote-Oakes sent an email to Cordovano and Zhou attaching "the final draft of Playlogic's financial statements," and asking: "Can you please have a staff foot the

⁹ Respondents point to a March 19, 2009, "substantive" email exchange between Zhou and Quijote-Oakes as evidence that Zhou was supervising the audit as the engagement partner for the Playlogic audit as of that date. RPS at 14, citing R-7. Quijote-Oakes had sent an email to Zhou, copied to Cordovano, setting forth her accounting analysis of the manner in which Playlogic calculated the fair value of certain stock conversion rights the company had granted to lenders, and asking Zhou for her thoughts on the analysis. Zhou's one-sentence response—"Why the company has to do the calculation?"—was hardly substantive. In fact, if anything, it suggests a lack of familiarity with the accounting issues in the audit that is inconsistent with her having supervised the audit as the engagement partner.

¹⁰ Although the email communications in evidence include a time of day for each email, as well as the date, the emails involved individuals in different time zones, and some were produced to the Division by Quijote-Oakes, who was located in Ohio, while others were produced by the Firm, which was located in Colorado. As a result, I do not find it possible to make reliable findings as to the precise sequence of emails sent on a particular date that are not contained in a single exhibit. On the other hand, where a single exhibit includes a string of emails, I find it possible to make reliable findings as to the sequence of those emails, if not the precise times at which they were sent or received.

financial statements and review the [Management Discussion and Analysis (MD&A)] section [of Playlogic's Form 10-K]?" Cordovano, not Zhou, responded with an email, on which Zhou was not copied, advising Quijote-Oakes: "Attached is the MD&A review. Please note that many corrections are needed. The footing is complete and there were no errors. It is close to filing time. I will call you in shortly to firm this up." D-111.

Cordovano also sent an email advising Quijote-Oakes that the filing agent who would file Playlogic's Form 10-K in the SEC's EDGAR filing system would be sending her a draft EDGAR filing, and stating: "I will call [the filing agent] back in 10 minutes to read the MD&A corrections to her. I will now trace the footnotes." Once again, Cordovano did not copy Zhou on the email. In a response to Cordovano's email, Quijote-Oakes advised him that Noordeloos had "one change to the last version I emailed to you and [Zhou]." Cordovano responded to Quijote-Oakes that "footnote disclosure of comprehensive [income] is not allowed. Playlogic can use: Second income statement; Combined statement of comprehensive income[; or] Statement of stockholders' equity[.]" Again, he did not copy Zhou on the email. D-35.

Cordovano also sent Quijote-Oakes an email stating: "1. I have a set of Playlogic 2008 [work papers] here. We can go over those tomorrow. I have no problem with two hard files (just the coordination)[.] 2. Let me know when you are happy with Playlogic. I will ask [Zhou] to press the button." Yet again, Cordovano did not copy Zhou on the email. D-36.

Finally, Cordovano sent Quijote-Oakes another email stating: "[Zhou] signed off." Cordovano, however, did not copy Zhou on the email, and Zhou testified that she did not authorize the Firm's audit opinion on Playlogic's 2008 financial statements, and

that Cordovano did not ask her to do so. D-37; Tr. 56-57. Playlogic's 2008 Form 10-K, which included the Firm's unqualified opinion on its financial statements, was filed on March 31, 2009. J-2 at ¶ 33.

While they acknowledge that Cordovano took part in the communications described above, Respondents argue that he "was acting as a 'go-between' for Zhou and Quijote-Oakes, a role necessitated by their mutual antipathy." They assert that Cordovano "acted as an intermediary, in his role as responsible managing partner, to get the job done. His conduct did not involve, as alleged by the Division, coordinating the firm's audit" RPS at 15, 16.

The evidence supports Respondents' contention that Zhou and Quijote-Oakes were personally at odds. Tr. 580-82, 608, 857-58. Further, the Division did not prove by a preponderance of the evidence that Cordovano personally reviewed the MD&A section of Playlogic's 2008 Form 10-K or personally traced the footnotes in the financial statements. While Cordovano's emails can be read to suggest that he performed that work himself, Cordovano testified that he assigned the work to junior staff, and other witnesses agreed that such an assignment would have been consistent with Firm practice. Tr. 607-08, 615-17, 861.

Nevertheless, although Cordovano may not have performed the MD&A review and footnote tracing himself, at a minimum he coordinated that work, as alleged in the OIP. Moreover, the emails show that Cordovano advised Playlogic, through Quijote-Oakes, regarding the appropriate manner to disclose comprehensive income; communicated with the EDGAR filing agent regarding the filing of Playlogic's 2008 Form 10-K; and instructed Quijote-Oakes regarding the work papers for the audit and

expressed his intention to review them with her. All of those actions also substantiate the OIP's allegation that Cordovano coordinated the Firm staff's completion of the audit.

I also find that the Division proved by a preponderance of the evidence that Cordovano, rather than Zhou, authorized the issuance of the Firm's audit report. Although Cordovano's emails to Quijote-Oakes indicate that Zhou "signed off" on the Playlogic audit, Zhou denied that she authorized the Firm's audit report, and I found her testimony in that regard credible.

Respondents argue: "Common sense dictates that Zhou was at all times the engagement partner for Playlogic, and her denial of this fact is driven more by her desire to evade responsibility [for the audit] than any reality." RPS at 16. Respondents rest this argument on testimony that Zhou was upset by the PCAOB inspectors' critical comments on the Playlogic audit. R-22A at 11-14. The inspectors also made critical comments regarding the China Solar and ICOP audits, however, yet Zhou has never denied serving as the engagement partner for those audits. Id. at 1-10.¹¹

Although Cordovano claims that Zhou approved the issuance of the Firm's Playlogic audit report, I find it significant that he did not copy Zhou on his emails to Quijote-Oakes in which he indicated that that he would ask Zhou to "press the button" and that she had signed off. Moreover, the Firm's records do not reflect Zhou's approval of the audit. During the PCAOB's inspection of the Firm in June 2009, the inspectors

¹¹ Respondents also argue that "[t]he circumstances of Zhou's termination also call her motivations into question." RPS at 16 n.10. When the Firm terminated Zhou's employment, it withheld \$2,100 from her final paycheck to pay for services by the Firm's counsel that the Firm contended were personal to Zhou and unauthorized. On the evening of her termination, Zhou contacted the PCAOB and she later contacted several of the Firm's clients. She testified that ultimately she was able to obtain a portion of the amount the Firm had withheld after she filed a complaint with the Department of Labor. Tr. 158-63, 238-39, 242-44. The evidence indicates that Zhou was angry with Respondents at the time of her termination, but at the hearing her demeanor did not indicate any continuing hostility toward Respondents. I credit her testimony that she did not sign off on the Playlogic audit both because her demeanor indicated that her testimony was truthful, and because her testimony is supported by the documentary evidence.

selected the Playlogic audit for review. The Firm's records provided to the auditors reflected Honeck's electronic signature as the "lead audit partner" for the audit, with a date of June 6, 2009, and Zhou's electronic signature as the "concurring audit partner," with a date of June 8, 2009. D-3.

Zhou acknowledged that, as reflected in the Firm's records, she approved the Firm's Playlogic audit as the concurring partner. Tr. 157. Since she could not have served as both the engagement partner and the concurring partner, the Firm's records are consistent with Zhou's testimony, and inconsistent with Cordovano's testimony that Zhou signed off on the Firm's audit report on March 31, 2009, as the engagement partner. Further, it was apparent from Zhou's testimony that she took her responsibilities as an auditor very seriously. Therefore, I find that if Zhou had believed that she was responsible for the issuance of the Firm's audit report on Playlogic, she would have entered her signature on the work papers on or about March 31, 2009, reflecting that capacity. Similarly, she would not have certified that she performed a concurring review if she had approved the Firm's Playlogic audit report as the engagement partner.

Honeck testified that "[e]arly on in the inspection process" Zhou told him that "if the PCAOB inspectors asked her any questions regarding Play Logic [sic], she was going to state that she was not the engagement partner for the Play Logic engagement." He also admitted that when Zhou made that statement, she "may have" told him that "one reason for ... not wanting to be engagement partner was because, according to her, Mr. Cordovano's level of involvement in the Play Logic [sic] engagement was greater than hers." Honeck also admitted that Zhou also "may have" told him that "she did not feel she want[ed] to act as lead engagement partner because the majority of the work was

conducted by Ms. Quijote-Oakes, and Mr. Cordovano was involved in that engagement, somehow taking over her role.” Further, although the Firm’s records indicate that Honeck signed off on the audit as lead partner, Honeck testified that he did not place or authorize his signature on the audit, and that he did not know who placed his name in the Firm’s records indicating his sign-off on the audit. Tr. 894, 955, 959.

Accordingly, I reject Respondents’ arguments that Zhou functioned “at all times” as the engagement partner on the Playlogic audit. Instead, I find that the Division proved by a preponderance of the evidence that Cordovano authorized the issuance of the Firm’s Playlogic audit report on March 31, 2009.¹²

3. The ICOP Audit

ICOP, headquartered in Kansas, designed, engineered and marketed video surveillance products for public safety. It was an issuer, as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). On March 20, 2009, the Firm issued an audit report expressing an unqualified opinion on ICOP’s FY 2008 financial statements that was included in ICOP’s Form 10-K filed with the SEC. J-2 at ¶¶ 38-40.

¹² Respondents argue that Zhou’s participation in a meeting with Playlogic’s audit committee in April 2009, and her charging time to prepare for the meeting, as reflected in the Firm’s billing records, contradicts her testimony that she was not the engagement partner on the audit. Playlogic had attempted, without success, to schedule a telephonic meeting of Playlogic’s audit committee prior to the issuance of the Firm’s audit report and the filing of Playlogic’s Form 10-K on March 31, and Cordovano had advised Noordeloos that Zhou and Quijote-Oakes would report the results of the audit to the audit committee during the meeting, on behalf of the Firm, in light of his bar. D-24; D-26; D-34. On April 1, 2009, however, Quijote-Oakes resigned from the Firm. D-38. Noordeloos testified that the audit committee meeting eventually took place on April 22, 2009, and that Zhou took the lead in explaining the Firm’s audit to the audit committee. Tr. 1007-09, 1036-37. In addition, the Firm’s billing records show that during the period April 20-22, 2009, Zhou billed 8.5 hours for preparation for the Playlogic audit committee meeting, including reviewing work papers, and studying “software development costs, amortization and impairment related GAAP issues.” R-12. Respondents argue that this work was “consistent with the duties of an engagement partner.” RPS at 14. Zhou, on the other hand, testified that after Quijote-Oakes resigned, Cordovano asked her to help with the Playlogic engagement, and therefore she expended time reviewing the audit work papers in order to understand the audit work that had been performed. Tr. 207-11. Zhou’s participation in the audit committee meeting, and the work she billed for preparing for the hearing, in light of Quijote-Oakes departure, is not inconsistent with her testimony that Cordovano had relieved her of responsibility as engagement partner. More importantly, it does not outweigh the evidence indicating that on March 31, 2009, Cordovano, rather than Zhou, approved the issuance of the Firm’s audit report.

The OIP alleges: “Cordovano participated in the Firm’s audit of ICOP in the following manner:

- a. Cordovano advised Firm staff on the appropriate accounting treatments to be applied by ICOP to the modifications of options and to scrap inventory; Firm staff relied on Cordovano’s guidance in issuing the Firm’s audit report.
- b. Cordovano coordinated and evaluated the concurring review. On March 19, 2009, the concurring review partner assigned to the ICOP audit provided Cordovano with comments on the draft ICOP 2008 financial statements. Cordovano reviewed the comments and directed Firm staff to address the comments. On March 21, 2009, Cordovano learned that the Firm had issued the ICOP audit report without the concurring review having been completed. Upon learning this, Cordovano led a meeting with the concurring review partner, the Non-Equity Partner, and the Firm Equity Partner, at which it was agreed that the concurring review would be completed as soon as feasible.
- c. The Firm billed ICOP for a portion of Cordovano’s time working on the audit of ICOP’s 2008 financial statements. Specifically, with Cordovano’s knowledge, the Firm billed ICOP \$900 on its March 3, 2009 invoice, \$2,200 on its June 18, 2009 invoice, and \$600 on its July 10, 2009 invoice for Cordovano’s services.” OIP ¶ 20.

Cordovano had been the engagement partner for the Firm’s audit of ICOP’s 2007 financial statements. In January 2009, Zhou was appointed to serve as the engagement partner for the Firm’s audit of ICOP’s 2008 financial statements. Quijote-Oakes was the

manager for the audit and Ginsburg was a junior auditor. J-2 at ¶¶ 5-6; Tr. 97, 857.

During the audit, Cordovano was consulted about several ICOP accounting issues.

On March 10, 2009, Cordovano sent an email to Quijote-Oakes directing her to send him “a draft of the ICOP Form 10-K.” D-103. Quijote-Oakes testified that she was “[p]retty sure” she complied with Cordovano’s direction. Tr. 425. On the following day, March 11, Quijote-Oakes sent an email to Zhou, Cordovano, Ginsburg, and Koslofsky, ICOP’s CFO, indicating that Koslofsky would be making several changes to ICOP’s financial statements. Cordovano responded to Quijote-Oakes’ email, copying Zhou, and stated: “In accordance with a memo from [ICOP’s former CFO] last year, ICOP should have been amortizing the cost of [its] scrap inventory over a relatively short period of time. Please see [the former CFO’s] memo. You may have a change in accounting estimate.” D-18. Quijote-Oakes testified that ICOP had not been amortizing the cost of its scrap inventory, and that doing so, in accordance with Cordovano’s email, would have resulted in a change in an accounting estimate that would have affected ICOP’s financial statements. Tr. 428-29.

On March 12, 2009, Quijote-Oakes sent an email to Koslofsky, and others (including Zhou, but not Cordovano), in which she stated that “[a]fter discussion with the partners, we believe that the Company has two options on how to account for scrap inventory that [the Firm] can live with,” and listed the two possible accounting treatments, one of which was to amortize the cost of the scrap inventory in accordance with the former CFO’s memo. D-104. Quijote-Oakes testified that she believed that the phrase “discussion with the partners” in her email referred to a telephone conversation she had with Zhou and Cordovano regarding the issue. Tr. 430. In his testimony,

Cordovano asserted that he provided information regarding the proper accounting treatment for ICOP's scrap inventory "[b]ecause I had knowledge of this from my time as the partner [for] ICOP and I owed it to the company, not to mention the stakeholders in the company, to make sure that their financial statements were correct." Tr. 643.

Cordovano also provided advice regarding ICOP's accounting treatment for the modification of stock options. On February 24, 2009, Cordovano sent Quijote-Oakes an email in which he incorporated material that he had copied from an unidentified publication in the Firm's research files providing advice regarding the proper accounting for "Modification of Vested Share Options," and advised Quijote-Oakes: "I think illustration 13 may apply." On February 27, 2009, Quijote-Oakes sent an email to Cordovano in which she stated: "With [Koslofsky's] and your input, I believe we've determine[d] the answer to the issue relating to the unvested stock awards based on the guidance under Illustration 13c [in the materials that Cordovano had sent]." She attached an "updated analysis for your review" which cited Illustration 13c in the materials that Cordovano had sent as support for the accounting treatment. D-100; Tr. 422-24.

In his testimony, Cordovano asserted that he sent the material to Quijote-Oakes because "[s]he asked me about this issue," and, working from her home in Ohio, did not have access to the Firm's research files. Cordovano testified that he did not believe providing the material to Quijote-Oakes contravened the bar:

Because this issue was one that I was intimately familiar with when I was the engagement partner on it. So I was once again transferring to [Zhou] my knowledge, which was required under—which was in accordance with the partnership rotation standards.

Tr. 639.

Cordovano also arranged for Fleischman, who was a partner in another Denver-area registered public accounting firm, to serve as the concurring review partner for the ICOP audit. Fleischman testified that he understood that Cordovano contacted the senior partner in his firm seeking a concurring review partner; Cordovano testified that it was Fleischman's senior partner who approached him, seeking the work. In either case, on March 19, 2009, Cordovano discussed the matter with Fleischman and the senior partner and on behalf of the Firm retained Fleischman to serve as the concurring review partner for the ICOP audit. Tr. 261-62, 623-24; J-2 at ¶ 42.

Also on March 19, Cordovano sent Fleischman an email attaching "the latest draft of the financials," and advising Fleischman: "We have identified the high-risk areas. The files are ready for your concurring review." Cordovano did not copy Zhou, the engagement partner, on the email. On the same date, Fleischman sent Cordovano comments on ICOP's draft financial statements. Cordovano reviewed Fleischman's comments and directed Quijote-Oakes to address them. J-2 at ¶¶ 43-44; D-22; D-23A; R-8; Tr. 262-66.

On March 21, 2009, Fleischman went to the Firm's offices to review the ICOP work papers, and met with Zhou and Quijote-Oakes (who participated by telephone). During the meeting, Fleischman learned that ICOP's Form 10-K, which included the Firm's audit report on ICOP's financial statements, had been filed with the SEC the previous day, before his concurring review was completed. Tr. 118-20, 266-69. Cordovano and Honeck, who were in the office that day, also learned that the Form 10-K had been filed before the concurring review was completed, and they took part in a meeting, along with Zhou and Fleischman to discuss the problem. Honeck admitted that

Cordovano took charge at that point and made the decisions for the Firm about how to deal with the issue.¹³ J-2 at ¶¶ 45-46; Tr. 963-65.

Finally, the parties stipulated that:

The Firm billed ICOP for a portion of Cordovano's time, as follows: \$900 for a post-audit review of its financial statements included in ICOP's registration statement on Form S-1 on its March 3, 2009 invoice, \$2,200 for a "comfort letter" to ICOP's underwriter on its June 18, 2009 invoice, and \$600 on its July 10, 2009 invoice for Cordovano services for another such letter.

J-2 at ¶ 47; see also D-17; D-53; and D-72 (related invoices). Cordovano testified that at least the first stipulated billing was a mistake and that he did not know how it occurred, but offered no further explanation for the billings to ICOP. Tr. 640-41. Zhou testified that Cordovano reviewed all the Firm's billings for the ICOP audit, and decided what to charge the client, even though she served as the engagement partner. Tr. 104-05.

I find, therefore, that the Division proved by a preponderance of the evidence that:

(1) Cordovano advised Firm staff on the appropriate accounting treatments to be applied by ICOP to the modifications of options and to scrap inventory, and Firm staff relied on his guidance; (2) Cordovano coordinated and evaluated the concurring review for the ICOP audit in the specific respects set forth above; and (3) the Firm billed ICOP for Cordovano's time as stipulated by the parties, all as alleged in the OIP. OIP ¶ 20.

¹³ In their post-hearing submission, Respondents, citing testimony by Fleischman, appear to contend that Fleischman did not participate in the meeting. RPS at 19, citing Tr. 267-68, 305. Respondents, however, stipulated that Fleischman attended the meeting, and I find Fleischman's equivocal testimony insufficient to negate the stipulation. In any event, whether Fleischman participated is immaterial; the relevant evidence concerns Cordovano's involvement.

At the hearing, Honeck initially testified that he did not recall that Cordovano made the decisions about how to deal with the filing of ICOP's Form 10-K before the concurring review was completed. When shown testimony he gave during the investigation, however, Honeck agreed that Cordovano "took charge and made the decisions on how to deal with this issue." Tr. 962-63.

4. The Tombstone Audit

Tombstone, based in Colorado, manufactured and marketed custom playing cards. It was an issuer, as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). On March 31, 2009, the Firm issued an audit report expressing an unqualified opinion on Tombstone's FY 2008 financial statements that was included in Tombstone's Form 10-K filed with the SEC. J-2 at ¶¶ 48-50.

The OIP alleges: "Cordovano participated in the Firm's audit of Tombstone's 2008 financial statements in the following manner:

- a. Cordovano coordinated the performance of the Firm's fieldwork for the audit;
- b. Cordovano directed Tombstone to prepare its books and other information for the Firm's audit engagement team to review; and
- c. Cordovano coordinated the Firm's review of Tombstone's 2008 financial statements."

OIP ¶ 22.

Cordovano was the Firm's engagement partner for Tombstone's audits prior to the audit of its 2008 financial statements. In January 2009, responsibility for that audit was assigned to Honeck. Cordovano, however, had a long-standing relationship with Tombstone's CFO, and continued to communicate with the CFO regarding the 2008 audit even after Honeck became the engagement partner. Tr. 801-02, 939, 945-46.

On January 8, 2009, after the bar had become effective, Cordovano sent an email to Tombstone's CFO stating: "Tombstone is scheduled for January 19-22. Please have the books to us by Friday January 16." He did not copy Honeck on the email. D-7.

On March 10, 2009, Tombstone's CFO sent an email to Cordovano asking for "a quick update." Cordovano responded on the same date stating: "We will conclude our fieldwork once you provide the following documents or answer the following questions," with a list of the required documents, and advised the CFO to "call if you have any questions." Cordovano copied Melody Song, a junior Firm staff member who was working on the audit, on the email, but not Honeck. D-92.

On March 19, 2009, Cordovano sent an email message to Tombstone's attorney stating: "We have reviewed Tombstone's financial statements and have made certain revisions. Please draft the final version for our final review." On the same day, Tombstone's CFO responded to Cordovano's email, asking why the revised document "does not look like all the other ones we have submitted to the SEC." Cordovano responded on the same day, explaining that "the revenues, cost of sales and a portion of salaries, for each year, are lumped together in 'discontinued operations.' We want to keep the playing card component (discontinued operations) segregated from the software component (continuing operations) because that presentation is considered more useful to investors." Cordovano did not copy Honeck on his emails. D-21; Tr. 803-06.

On March 27, 2009, Cordovano sent another email to Tombstone's CFO stating: "Our staff made several editorial changes to the financials and they are satisfied with the presentation and disclosure. However, [Tombstone's in-house accountant] must complete the tax footnote ... before you can file the statements. We are not allowed to draft the footnotes as it appears to impair our independence." For reasons he could not explain at the hearing, Cordovano did not copy Honeck on this email, but did copy Zhou, who was not working on the Tombstone audit. D-31; Tr. 807-09, 811, 813-14.

I find, therefore, that the Division proved by a preponderance of the evidence, that, in the manner and to the extent reflected in the emails cited above, Cordovano coordinated the performance of the Firm's fieldwork for the audit; directed Tombstone to prepare its books and other information for the Firm's audit engagement team to review; and coordinated the Firm's review of Tombstone's 2008 financial statements, as alleged in the OIP. OIP ¶ 22.

III. Discussion and Conclusions

A. Violation

Section 105(c)(7)(A) of the Act makes it "unlawful for any person that is suspended or barred from being associated with a registered public accounting firm ... willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the [SEC]." Similarly, PCAOB Rule 5301(a) provides that "[n]o person that is ... barred from being associated with a registered public accounting firm ... may willfully become or remain associated with any registered public accounting firm, without the consent of the Board ... or the [SEC]," and Rule 5301(b) provides that "[n]o registered public accounting firm that knows ... of the ... bar of a person may permit such person to become or remain associated with it, without the consent of the Board ... or the [SEC]."

It is undisputed that during the period at issue in this proceeding, Cordovano was barred from being associated with a registered public accounting firm, and the Firm was a registered public accounting firm. Further, Respondents do not claim, and there is no

evidence, that Cordovano or the Firm sought or obtained the consent of the Board or the SEC for Cordovano to associate with the Firm. Finally, it is beyond dispute that the Firm, through Cordovano and Honeck, its owners, was well aware that Cordovano was subject to a bar at the relevant time. The issue presented, therefore, is whether the facts, as set forth above, establish that Cordovano willfully became or remained associated with the Firm.

During the relevant period, Cordovano continued to be a partner and co-owner of the Firm. As the Division indicated in its December 23, 2008 letter, however, the bar did not necessarily preclude Cordovano from continuing in those roles.

The PCAOB does not exercise plenary authority over public accounting firms or their employees. Instead, under the Act, the PCAOB's authority addresses one of a number of roles filled by CPAs—the auditing of issuers. The definition of “associated person” set forth in Section 2(a)(9)(A) of the Act at the relevant time reflected the PCAOB's limited authority:¹⁴

The terms “person associated with a public accounting firm” (or with a “registered public accounting firm”) and “associated person of a public accounting firm” (or of a “registered public accounting firm”) mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

¹⁴ In July 2010, after the events at issue in this proceeding, the definition of associated person was amended by the Investor Protection and Securities Reform Act of 2010 in respects not relevant to this proceeding.

Rule 1001(p)(i) sets forth the same definition, but omits the words “or otherwise” after the phrase “participates as agent,” and further, pursuant to the authority granted by Section 2(a)(9)(B) of the Act, provides that “a person engaged only in clerical or ministerial tasks or a person whom the public accounting firm reasonably believes is a person primarily associated with another registered public accounting firm” will not be deemed to be an associated person of that firm.

The OIP’s allegations, and the Division’s arguments, rest on the second portion of the definition—“participates as agent ... on behalf of such accounting firm in any activity of that firm [in connection with the preparation or issuance of any audit report]”; the OIP does not allege, and the Division does not argue, that the first portion of the definition—“shares in the profits of, or receives compensation in any other form from, that firm [in connection with the preparation or issuance of any audit report]”—applies.

Respondents argue that the associated person definition is vague, and that they adopted a reasonable interpretation of it, under which Cordovano “focused on the Division’s instructions concerning receiving compensation from audits of public companies, and participating as an agent on behalf of a public company accounting firm. ... Specifically, Mr. Cordovano understood the letter to say that he (1) could not bill public clients, and (2) could not disassociate with the firm and circumvent the bar by acting as a contractor or agent.” RPS at 7. Further, Respondents argue: “Logically relying on the portion of the [Division’s] letter stating ‘[t]he Order does not necessarily preclude Mr. Cordovano from continuing to be a partner in the Firm[,]’ Mr. Cordovano understood that he could continue as managing partner, with all of the ordinary managerial responsibility that the position entails.” *Id.* at 6.

Respondents' contention that they relied on the Division's December 2008 letter is untenable. First, the Division did not give Respondents any "instructions" regarding compliance with the 2008 Order. On the contrary, the letter expressly stated that "the staff cannot provide legal advice or advise whether any particular future conduct of Mr. Cordovano ... would be consistent with PCAOB Rules or Standards or with a bar." R-29 at 1. Second, Respondents could not reasonably have interpreted the Division's statement in the letter that the bar did "not necessarily preclude Mr. Cordovano from continuing to be a partner in the Firm" (*id.* at 2) as indicating that Cordovano was free to participate in audits of issuers on behalf of the Firm, in spite of the bar, so long as he could relate that participation in some way to his role as the Firm's managing partner.

Similarly, Respondents' contention that they understood the word "agent" to mean simply that Cordovano could not disassociate from the Firm and participate in the Firm's audits as a contractor is both unreasonable and not credible. It is apparent from the context in which the word agent is used that it is intended to broaden, not limit, the definition of associated person, in order to ensure that it encompasses any professional who participates in an audit of an issuer on behalf of a registered public accounting firm, whether or not employed by the firm. As a partner and co-owner of the Firm, Cordovano was unquestionably acting as its agent, and it is not credible that Cordovano, an experienced accountant who acknowledged that "[a]gency was a part of my business law training in college" (Tr. 539), did not understand that he was an agent of the Firm.¹⁵

Further, the testimony of both Cordovano and Honeck evinced a clear understanding that the bar applied to Cordovano's activities as a partner in the Firm.

¹⁵ Respondents have never argued that any of Cordovano's actions were *ultra vires*, or otherwise beyond the scope of his authority as co-owner and managing partner of the Firm, and there is no evidence in the record that would support such a contention.

Thus, Cordovano acknowledged that he knew he was “barred from participating in an audit of an issuer,” and that as a result he could not “prepare work papers or review them,” and he claimed that he decided not to analyze China Solar’s equity purchase agreements, as he had promised Zhou, because he was concerned that such work “might call into question” his compliance with the bar and therefore he “didn’t think it was appropriate.” Similarly, Honeck acknowledged that he understood Cordovano “could not be involved in the audits of public companies” and “should not be instructing the staff if it was related to performing a public company audit.” Tr. 537-41, 663, 827-28, 831, 906, 931.

Respondents also argue that Cordovano’s activities in connection with the audits at issue did not make him an associated person. In that regard, however, the definitions in the Act and the Board’s rules are comprehensive, encompassing participation in “any activity” in connection with the preparation or issuance of an audit report for an issuer. Here, as set forth above, the evidence establishes that Cordovano participated in significant activities of the Firm in connection with all four audits. Among other things, he advised Zhou on two important issues during the China Solar audit; he coordinated the completion of the Playlogic audit and authorized the issuance of the Firm’s opinion; he advised the audit team on important accounting issues and, in certain respects, coordinated the concurring review during the ICOP audit; and he coordinated audit work, and gave directions to the client in that regard, during the Tombstone audit. Cordovano also supervised post-audit work related to the Firm’s China Solar audit, and billed ICOP for post-audit work related to the Firm’s opinion.

Respondents argue that Cordovano's activities were outside the definition of associated person because he was acting in the role of managing partner, or was sharing his knowledge as the former engagement partner for the client with the Firm's audit team, or was training junior staff assigned to the audits.¹⁶ But the definition of associated person does not exempt any of those roles from its reach. The evidence established that Cordovano influenced the conduct of all four audits in important ways. At a minimum, he provided the frameworks for Zhou to analyze the China Solar consolidation issue and to address a material weakness in internal controls; he coordinated the completion of the Playlogic audit work, including instructing the client, through Quijote-Oakes, on the proper presentation of comprehensive income in the financial statements, and he authorized the issuance of the Firm's opinion; he influenced the audit team's assessment of ICOP's accounting for the modification of options and scrap inventory; and he coordinated Tombstone's cooperation with the Firm's audit team. It would be nonsensical to suggest that an accountant could engage in such activities without becoming an associated person.

In the context of a bar, that conclusion is even more apparent. To support a bar, the Board must find, as it did in the 2008 Order, that the barred person committed intentional or reckless violations, or repeated negligent violations, of PCAOB auditing standards or rules, or the securities laws. Permitting a person who engaged in such conduct to become as deeply involved in the audit process as Cordovano was in the China Solar, Playlogic, ICOP, and Tombstone audits would be fundamentally

¹⁶ Respondents also argue that some of Cordovano's activities were not covered by the definition of associated person because they were merely "clerical or ministerial tasks." The exemption from the definition of associated person in Rule 1001(p)(i), however, applies to "a person engaged only in clerical or ministerial tasks," not to the tasks themselves. Cordovano's work as a partner in the Firm involved far more than clerical or ministerial tasks. As a result, the exemption does not apply.

inconsistent with the goal to “protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports” set forth in Section 101(a) of the Act. Plainly, a barred individual should not be advising the engagement partner or the audit manager on the proper analysis of important accounting issues, as Cordovano did in the China Solar and ICOP audits; and should not be coordinating the completion of an audit, authorizing the issuance of an audit report, or directing an issuer in connection with an audit as Cordovano did in the Playlogic and Tombstone audits. Indeed, as Honeck acknowledged, a barred individual “should not be instructing the staff if it was related to performing a public company audit” in any respect.

Respondents also argue that Cordovano’s post-audit activities regarding China Solar and ICOP were not “in connection with the preparation or issuance of any audit report,” and thus were not covered by the definition of associated person or the bar. The Act, however, is remedial legislation intended for the protection of investors and it is a “familiar canon of statutory construction that remedial legislation should be construed broadly to effectuate its purposes.” Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) (noting that “[t]he Securities Exchange Act quite clearly falls into the category of remedial legislation”). The Board’s auditing standards reflect the Board’s understanding that in order to “protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports,” the Act must reach work performed both before and after the audit itself that is related to the preparation and issuance of the audit report, and the SEC’s approval of those standards indicates the SEC’s concurrence in the Board’s interpretation of the Act.

Accordingly, PCAOB auditing standards explicitly addressed the Firm's performance of procedures it had omitted from the China Solar audit, after the PCAOB inspection. See AU § 390, Consideration of Omitted Procedures After the Report Date. PCAOB auditing standards also addressed the Firm's work relating to the inclusion of its report in China Solar's S-1 filing, and the similar work by Cordovano for which the Firm billed ICOP. See AU § 711, Filings Under Federal Securities Statutes. Because the work was addressed by the PCAOB's auditing standards, Respondents were on notice that it was "in connection with the preparation or issuance of" the Firm's audit reports, and thus within the scope of the definition of associated person. Therefore, Respondents also had notice that the bar prohibited Cordovano from participating in any activity of the Firm in connection with that work.

I conclude, therefore, that, as a result of his participation in the Firm's activities in connection with the China Solar, Playlogic, ICOP, and Tombstone audits, as set forth above, Cordovano became or remained an associated person of the Firm. The remaining question is whether his association was willful.

Respondents argue that to establish willfulness, the Division had to prove that Cordovano acted with scienter. In support, they point to the OIP's allegation that "Cordovano's violations resulted from intentional or knowing conduct, including reckless conduct," and that "the Firm's violations resulted from intentional or knowing conduct, including reckless conduct," or, alternatively, "involved repeated instances of negligent conduct." OIP ¶¶ 28, 33-34.

Respondents' argument is without merit. "Willfulness is usually understood to be contextual. ... 'It is only in very few criminal cases that "willful" means done with a bad

purpose. Generally, it means no more than that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.” Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)).

The portions of the OIP cited by Respondents address scienter in a different context—sanctions. As discussed in greater detail below, Section 105(c)(5) of the Act provides that the PCAOB may only impose certain sanctions authorized in Section 105(c)(4) of the Act if the respondent engaged in “intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or ... repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.” By making scienter expressly relevant to the sanctions issue, the Act confirms that scienter is not required to establish willfulness for purposes of finding a violation. See Gately & Assocs., LLC, Exch. Act Rel. No. 62656, 2010 SEC LEXIS 2535, at *27 (Aug. 5, 2010). Accordingly, I conclude that, as in other sections of the securities laws, willfulness for purposes of Section 105(c)(7)(A) of the Act and Rule 5301 requires only that the person charged “knows what he is doing.”

Based on Cordovano’s own testimony, it is beyond dispute that he knew what he was doing when he engaged in the activities in connection with the China Solar, Playlogic, ICOP, and Tombstone audits described above. Therefore, his conduct was willful within the meaning of Section 105(c)(7)(A) of the Act and Rule 5301(a).¹⁷

¹⁷ Even if scienter were required to establish willfulness, for reasons set forth below in the discussion of sanctions, that requirement would be satisfied in this case.

I conclude, therefore, that Cordovano, after being barred from being associated with a registered public accounting firm by the 2008 Order, willfully remained or became an associated person of the Firm, in violation of Section 105(c)(7)(A) of the Act and Rule 5301(a), and that the Firm, with knowledge of the bar, permitted the association, in violation of Section 105(c)(7)(A) of the Act and Rule 5301(b). Furthermore, Cordovano, by willfully remaining or becoming an associated person of the Firm, in contravention of the bar set forth in the 2008 Order, and the Firm, by allowing Cordovano to do so, also violated Rule 5000, which requires registered public accounting firms and their associated persons to “comply with all Board orders to which the firm or person is subject.”

B. Substantial Compliance Defense

In their pre-hearing submission, Respondents asserted for the first time in this proceeding that they cannot be held to have violated Section 105(c)(7)(A) of the Act and Rules 5000, 5301(a) and 5301(b), as charged, because they “substantially complied” with the bar imposed by the 2008 Order. Respondents reiterated this substantial compliance defense in their post-hearing submission. RPS at 25-27.

As Respondents note, in contempt of court cases, some courts have held that “a finding of contempt [may] be averted where diligent efforts result in substantial compliance with the underlying order.” Accusoft Corp. v. Palo, 237 F.3d 31, 47 (1st Cir. 2001). The Division, however, argues that this substantial compliance defense is inapplicable to PCAOB proceedings, and that, even if the defense were applicable, Respondents failed to demonstrate that they made diligent efforts that resulted in substantial compliance with the bar.

I agree with the Division on both points. First, Respondents' contention that this proceeding is analogous to a contempt proceeding is incorrect. This is a disciplinary proceeding specifically authorized by Section 105(c)(7)(A) of the Act, not a contempt proceeding. The PCAOB's disciplinary proceedings are modeled on the disciplinary proceedings of the securities industry self-regulatory organizations (SROs), and as the SEC recently noted in a PCAOB case, "we have rejected similar attempts to apply civil contempt principles to violations of the rules of SROs." Gately, 2010 SEC LEXIS 2535, at *29.

Second, the evidence is fundamentally inconsistent with a finding that Respondents made "diligent efforts" to comply with the bar. On the contrary, after the 2008 Order was issued, Respondents established no written policies and procedures to assist the partners or the Firm staff in complying with the bar. Instead, Respondents' primary response to the bar was to make Zhou a non-equity partner and assign her as the engagement partner for a number of Firm audits of issuers. Because Zhou had no prior experience as an auditor of an issuer, in any role, Respondents knew that she would require a good deal of support from a more experienced auditor in order to fulfill her responsibilities, and they assigned Cordovano, who was barred, to provide that support. Tr. 982. This does not constitute taking "all reasonable steps to insure compliance." RPS at 25.

Respondents argue that their response to the bar was reasonable because neither the 2008 Order nor the Division's subsequent letter "provided anything in the way of clear instructions as to 'precisely what acts are forbidden.'" RPS at 25-26, quoting Accusoft Corp. v. Palo, 237 F.3d at 47. As explained above, however, the 2008 Order,

the Act, the PCAOB's rules, and the Division's letter all clearly notified Respondents that Cordovano could not participate in any activity of the Firm in connection with the preparation or issuance of any audit report for an issuer. Further, Cordovano's and Honeck's testimony demonstrated that they both understood the scope of the bar. Finally, given the myriad ways in which an accountant can participate in audit activities, as demonstrated by Cordovano's activities, the Board and the Division could not have provided, and Respondents were not entitled to, a more detailed description of the prohibited acts.

The evidence also shows that Respondents' inadequate efforts did not lead to substantial compliance with the bar. As set forth above, Cordovano engaged in activities in connection with four separate audits that were proscribed by the bar. The number and range of those activities preclude any finding of substantial compliance.¹⁸

Therefore, I conclude that Respondents' substantial compliance defense is both legally and factually unsupported, and it is rejected.

C. Sanctions

The first issue in determining the appropriate sanctions for Respondents' violations is whether they resulted from "intentional or knowing conduct, including reckless conduct," or from "repeated instances of negligent conduct, each resulting in a violation" of relevant standards, within the meaning of Section 105(c)(5) of the Act. If either type of conduct occurred, the full range of potential sanctions set forth in Section

¹⁸ I reach this conclusion without regard to Cordovano's post-audit activities. Even assuming those activities did not come within the definition of associated person, or if Cordovano reasonably believed they did not, his activities during the course of the four audits preclude any finding that Respondents substantially complied with the bar.

105(c)(4) of the Act and PCAOB Rule 5300 is available; if not, the potential sanctions are far more limited.

The SEC has held that “the knowledge, recklessness, and negligence standards in Section 105(c)(5) ... are similar to the standards for Commission discipline of accountants under Rule 102(e) of our Rules of Practice” Gately, 2010 SEC LEXIS 2535, at *32. The SEC further explained: “Recklessness in this context, as under Rule 102(e), is an ‘extreme departure from the standards of ordinary care, . . . which presents a danger’ to investors or the markets ‘that is either known to the (actor) or is so obvious that the actor must have been aware of it.’” Id. at *33 (footnote omitted). There is thus a two-prong test for evaluating whether Respondents’ conduct was reckless: (1) whether their conduct represented an “extreme departure” from applicable standards; and (2) whether they “knew or must have known” that their conduct presented a danger to investors or the market. Id. at **34, 39.

Respondents argue that the evidence does not support a finding of recklessness because: (1) they sought assistance from the Division regarding their obligations under the bar and received no detailed description of the conduct that was covered by the bar; (2) they adopted a reasonable interpretation of the bar’s prohibitions; (3) they made a reasonable response to the bar, as they understood it; and (4) Cordovano did not intend to violate the bar.

First, neither the Board nor the Division had a duty to provide Respondents with a roadmap to compliance. The SEC has “long held that regulated persons cannot avoid responsibility for their own violative conduct by blaming the Commission or other regulators.” Gately, 2010 SEC LEXIS 2535, at *53. Furthermore, as explained above,

the definition of associated person is broad, and encompasses a wide range of audit-related activities, and as a result, neither the Board nor the Division could have provided, in advance, a more detailed description of the conduct prohibited by the bar.

Second, as explained above, I reject Respondents' purported interpretation of the bar as neither reasonable nor credible. In fact, the testimony of both Cordovano and Honeck shows that they understood that the bar imposed a broad prohibition on Cordovano's involvement in audits of issuers.

Third, again as explained above, Respondents did not take reasonable steps to comply with the bar. In that regard, it is particularly troubling that Respondents seek to blame Zhou for their violations, asserting that "[i]n hindsight, Zhou was not qualified [to be the engagement partner on the Firm's audits]," and that, "[f]acing exigent client needs and an employee who was failing, Cordovano answered Zhou's requests for guidance and training. He answered Zhou because it was necessary to protect her, the [F]irm, and the interests of its clients and their shareholders." RPS at 1-2.

The exigencies that Respondents identify were caused, not by Zhou, but by Respondents' own decisions. Although Respondents accuse Zhou of "puffing her ability" (RPS at 1 n.1), in fact, Cordovano and Honeck were well aware that Zhou had no experience auditing issuers when the Firm hired her and when it assigned her to be the engagement partner on several audits. Respondents assert that Zhou "represented herself to be qualified" and that she "believed that she was qualified to be an engagement partner for public issuer clients." RPS at 1, 10. I find credible, however, Zhou's testimony that she understood she was hired for an audit manager position, and that she had "confidence in [herself] to work as [an] accounting manager." Tr. 30. I further credit her testimony

that when Cordovano approached her about becoming a non-equity audit partner in January 2009, she did not “feel that confident to work as [an] engagement partner, but Mr. Cordovano told [her] he [could] walk [her] through.” Tr. 36.

In any event, unlike Zhou, both Cordovano and Honeck were experienced auditors of issuers, and therefore must have been aware that Zhou could not possibly complete her assignments successfully without substantial oversight and input from at least one of the partners. Yet Cordovano, with Honeck’s knowledge and implied consent, assigned that role to himself, even though he was barred from participating in the issuer audits to which Zhou was assigned. Both Cordovano and Honeck must have known that this arrangement was inconsistent with the requirements of the bar. And while Cordovano may not have specifically intended to violate the bar, the evidence shows that he deliberately remained deeply involved in the Firm’s issuer audits in spite of the bar. Such involvement was implicit in the decision to make Zhou the non-equity engagement partner for numerous issuer audits, even though she was plainly not qualified to act in that role, and explicit in Cordovano’s subsequent oversight of and participation in the audits, as discussed above.

I conclude that, rather than making reasonable efforts to comply with the bar, Respondents’ conduct in allowing Cordovano to participate in Firm activities in connection with the preparation and issuance of audit reports represented an extreme departure from applicable standards. Cordovano and Honeck were both aware that Cordovano was prohibited from participating in any activity of the Firm in connection with its audits of issuers. Cordovano, however, while formally withdrawing from the Firm’s audits, monitored their progress and intervened behind the scenes in order to

influence auditing and accounting decisions. Cordovano must have known that his actions were impermissible in light of the bar.

Respondents contend that Cordovano was merely responding to Zhou's questions and acting as an intermediary between Zhou and Quijote-Oakes, "a role necessitated by their mutual antipathy." RPS at 15. The facts as set forth above demonstrate that Cordovano was far more involved than simply responding to questions or acting as an intermediary. Further, Cordovano must have realized, as Honeck did, that the bar prohibited him from "instructing the staff if it was related to performing a public company audit," regardless of his reasons for intervening.¹⁹

Finally, I note that Cordovano had been barred by the 2008 Order based on a finding, to which Respondents consented, that he had engaged in intentional or knowing misconduct, including reckless conduct, or repeated instances of negligent misconduct. Accordingly, I conclude that Respondents knew or must have known that allowing Cordovano to participate in the audits of issuers in the manner and to the extent that he participated in the audits of China Solar, Playlogic, ICOP, and Tombstone presented a danger to investors or the market.

Therefore, I conclude that Cordovano's conduct constituted "intentional or knowing conduct, including reckless conduct," within the meaning of Section 105(c)(5)

¹⁹ Indeed, some of Cordovano's actions support an inference that he was aware that he was violating the bar. These actions include signing Honeck's name to an email to China Solar's management, and composing emails to Playlogic's management that he directed Zhou to send in her name. I reject as not credible Cordovano's testimony that he composed the Playlogic emails to assist Zhou, because of her limited English skills. The email communications themselves do not support Cordovano's claim; rather, they simply reflect Cordovano directing Zhou to send the client messages he had composed, and I credit Zhou's testimony that Cordovano asked her to send the messages because "he [could not] do the work until [the] fall of 2009" because of the bar. D-46; D-49; Tr. 58-61, 620-21. Because the Playlogic emails did not directly relate to the conduct charged in the OIP, however, I have not considered them in concluding that Cordovano engaged in intentional or knowing conduct, including reckless conduct.

of the Act. The Firm also engaged in “intentional or knowing conduct, including reckless conduct,” within the meaning of Section 105(c)(5) of the Act. Cordovano’s scienter can be imputed to the Firm, since he was part-owner. In addition, Honeck, the other co-owner, was generally aware of Cordovano’s activities and took no steps to prevent Cordovano from participating in the Firms’ audits. At a minimum, the Firm engaged in “repeated instances of negligent conduct, each resulting in a violation” of the Act and PCAOB rules.

Accordingly, I find that the full range of sanctions under Section 105(c)(4) of the Act is available to address Respondents’ violations. The SEC has identified certain “public interest factors” as relevant in determining what specific sanctions are appropriate, including “the egregiousness of the respondent’s actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent’s assurances against future violations; the respondent’s recognition of the wrongful nature of his conduct; and the likelihood of future violations. [The] inquiry into the appropriate remedial sanction is a flexible one, and no one factor is dispositive.” Chris G. Gunderson, Exch. Act Rel. No. 61234, 2009 SEC LEXIS 4322, at *20 (Dec. 23, 2009) (footnotes and internal quotation marks omitted).

In this case, Respondents’ conduct was highly egregious. Following the bar, the Firm adopted no written guidelines to ensure that Cordovano would not participate in audits of issuers. Instead, Respondents’ primary action was to remove Cordovano from overt participation in the Firm’s audits of issuers by appointing Zhou as the non-equity engagement partner, while allowing Cordovano to remain involved in the audits behind the scenes. As explained above, Respondents’ conduct was intentional or reckless, or at a

minimum involved repeated negligent violations. Further, Respondents have not shown any recognition of the wrongful nature of their misconduct; instead, they have offered a variety of rationalizations.

All of these factors support imposing a permanent bar on Cordovano. Respondents, however, argue that such a bar is unnecessary because Cordovano is already subject to the bar in the 2008 Order. Respondents acknowledge that the 2008 Order allows Cordovano to petition the Board for consent to associate with a registered public accounting firm, but they argue that “Cordovano has no intention of petitioning for such approval, which would be an exercise in futility.” RPS at 28. Cordovano’s current intent, however, would not preclude him from petitioning for consent to associate at some future date. In any event, a permanent bar is an appropriate remedial sanction because it signals to Cordovano and others, who may be in similar situations, the importance of complying with Section 105(c)(7)(A) of the Act and Rules 5000 and 5301(a).

I also find it appropriate to revoke the Firm’s registration. Respondents argue that “[t]he primary impact of [a revocation] would primarily fall on Honeck, who was conclusively shown at the hearing to have done nothing wrong.” RPS at 28. In fact, Honeck’s own testimony showed that he took no steps to ensure that Cordovano and the Firm complied with the bar, and closed his eyes in the face of evidence that Cordovano was engaging in activities in connection with audits of issuers that Honeck recognized violated the bar. The revocation of the Firm’s registration, which is fully justified under the public interest factors identified by the SEC, thus works no unfairness on Honeck.²⁰

²⁰ A civil money penalty is also a potential sanction under Section 105(c)(4) of the Act; the other types of sanctions authorized by that provision or by Rule 5300 have little utility in light of the permanent bar of Cordovano and revocation of the Firm’s registration. In evaluating whether a civil money penalty is an appropriate sanction and, if so, the amount of the penalty, the Board has considered the factors set forth in

IV. Record Certification

Pursuant to Rule 5202(d), I certify that the record includes the items set forth in the Revised Record Index sent to the parties by the PCAOB Secretary on June 24, 2011.

V. Order

In accordance with the findings and conclusions set forth above, pursuant to Section 105 of the Sarbanes-Oxley Act of 2002 and PCAOB Rule 5300, Respondent Samuel D. Cordovano is permanently barred from associating with any registered public accounting firm and Respondent Cordovano and Honeck LLP's registration with the Board is permanently revoked.

This Initial Decision shall become final, in accordance with Rule 5204(d)(1), upon issuance of a notice of finality by the Secretary. Any party may obtain Board review of this Initial Decision in accordance with Rule 5460(a), or the Board may, on its own initiative, order review, in which case this Initial Decision will not become final.²¹



David M. FitzGerald
Hearing Officer

Section 21B(c) of the Securities Exchange Act of 1934 as providing helpful and relevant guidance. Larry O'Donnell, CPA, P.C. and Larry O'Donnell, CPA, PCAOB File No. 105-2010-002 (Oct. 19, 2010), at 9-10.

In this case, those factors might well support the imposition of a substantial civil money penalty, at least as to Cordovano. The Division, however, did not request the imposition of a civil money penalty and Respondents did not address the penalty issue in their post-hearing filing, presumably because the Division did not seek a penalty. Although those factors do not preclude a penalty, to impose a penalty without offering Respondents a clear opportunity to address the relevant factors might raise fairness concerns. Furthermore, I do not find a penalty essential to accomplish the PCAOB's remedial and disciplinary goals under the facts of this case. Accordingly, no civil money penalty will be imposed.

²¹ Arguments and contentions of the parties not specifically addressed herein are adopted or rejected to the extent that they are consistent or inconsistent with the findings and conclusions set forth.