

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of Ron Freund, CPA, Respondent)	PCAOB File No. 105-2009-007
)	ORDER SUMMARILY AFFIRMING
)	FINDING OF VIOLATION AND
)	IMPOSITION OF SANCTION
)	January 26, 2015

This proceeding is before the Board on Respondent Ron Freund's petition for review of the hearing officer's initial decision. The initial decision found that Freund violated PCAOB Rules 3100 and 3200T by failing to comply with a provision of PCAOB auditing standards in connection with the audit of the consolidated financial statements of Taro Pharmaceutical Industries Ltd. (Taro) for the year ending December 31, 2004, and, for that violation, the decision imposed the sanction of a censure. Against the background described below, including that Freund has since effectively rendered his petition for review moot and stated that he accepts the initial decision, we summarily affirm the finding of the violation and the imposition of the censure.

The initial decision found the following facts to be undisputed. At all relevant times, Taro was an issuer, as defined by Section 2(a)(7) of the Sarbanes-Oxley Act, 15 U.S.C. 7201(7), and PCAOB rules. Freund was a person associated with a registered public accounting firm—Kost Forer Gabbay & Kasierer—as defined by Section 2(a)(9) of the Act, 15 U.S.C. 7201(9), and PCAOB rules. Kost Forer audited Taro's consolidated financial statements for the year ending December 31, 2004. Freund was the Kost Forer lead engagement partner on that audit. In that audit, Kost Forer used the work of another independent auditor in circumstances to which AU § 543, *Part of Audit Performed by Other Independent Auditors*, applied. Kost Forer did not refer to the other auditor in its audit report expressing an unqualified opinion on Taro's 2004 financial statements. That audit report, dated February 23, 2005, was included in Taro's Form 20-F filed with the Securities and Exchange Commission on June 30, 2005.

AU § 543.12 states, in part, "When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in" AU § 543.10—matters not at issue here—"the principal auditor must obtain, and review and retain, the following information from the other auditor:...b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures....The principal auditor must obtain, and review and retain, such documents prior to the report release date" (footnote omitted). The Order Instituting Disciplinary Proceedings alleged that Freund "never obtained any evidence concerning whether [the other independent auditor] performed any retrospective review

of prior year estimates [of sales allowances, including chargebacks, as part of the audit work used by Kost Forer], although auditing standards required the performance of such a review,” and that Freund’s “failure to do so violated” AU § 543.12.b. AU § 316.64 provides that an auditor “should perform a retrospective review of significant accounting estimates reflected in the financial statements of the prior year.” It is undisputed that a retrospective review relates to the risk of fraud. The review’s purpose is to determine whether management judgments and assumptions relating to the estimates indicate a possible bias, as a means of obtaining additional information about possible management bias in making the current year’s estimates.

The initial decision determined that although Freund had cited information that may have supported an inference that the other independent auditor had performed the retrospective review, this was not direct evidence, or a clear description, of the results of that procedure and was not enough to satisfy the obligation under AU § 543.12.b to obtain, and review and retain, the results of the other auditor’s procedures relating to fraud risk factors. The decision found that Freund violated AU § 543.12.b through a single instance of negligent conduct. It ordered that he be censured for that conduct.

Freund filed a Petition for Review that took exception to the initial decision’s disposition of this charge. A subsequent brief filed on Freund’s behalf, however, stated that “[a]lthough Mr. Freund disagrees with the Hearing Officer’s conclusion that he violated AU § 543.12.b, he is willing to accept that decision” and no longer seeks Board review of that ruling. In light of that statement, the Board finds that the issue raised by Freund’s petition for review does not warrant further consideration. We summarily affirm the initial decision’s finding that Freund violated AU § 543.12.b. We also summarily affirm the initial decision’s imposition of a censure as an appropriate sanction for that conduct. See PCAOB Rule 5460(e).

To avoid any misimpression that issuance of this order and our summary affirmance of the initial decision might create, we think it appropriate to make clear that we affirm the initial decision only to the extent of its disposition of these matters, not to the extent it may offer or suggest a larger interpretation of AU § 543 that is unnecessary to such disposition. The initial decision, in an introductory discussion of AU § 543 that preceded its finding that Freund had violated AU § 543.12.b and its imposition of the censure, used language that seemed to indicate that Freund’s responsibilities with respect to use of the other independent auditor’s work were set forth exclusively by AU § 543. In circumstances to which AU § 543 applies and no reference is made to the other auditor, the principal auditor must comply with certain provisions of AU § 543, and the engagement partner for the principal auditor is responsible for the principal auditor’s compliance with the requirements of AU § 543. But to broadly suggest, as the language in the initial decision might, that those are the engagement partner’s only responsibilities with respect to use of the other auditor’s work, as if the engagement partner automatically or inevitably satisfies them solely by taking the steps listed in AU § 543.10 and § 543.12, fails to situate the responsibilities within the context of the overall audit.

In the circumstances described, the other auditor's work "relates to the principal auditor's expression of an opinion on the financial statements taken as a whole." AU § 543.03 & .04. The obligations imposed by AU § 543 cannot artificially be divorced from the objective of the use of the work and report of the other auditor or the nature of the review of the information required to be reviewed by the principal auditor. Moreover, to carry out those obligations, professional judgment must be exercised by and on behalf of the principal auditor,^{1/} and the exercise of professional judgment "must be 'guided by sound' auditing principles." *McCurdy v. SEC*, 396 F.3d 1258, 1263 (D.C. Cir. 2005).

The engagement partner for the principal auditor performs his or her role against the background of all PCAOB standards. This means, among other things, that the obligations described in AU § 543 must be carried out with the due care, including professional skepticism, required by AU § 230. That, in turn, means that the engagement partner must respond appropriately, including with a questioning mind engaged in a critical assessment (AU § 230.07), to indications that the other independent auditor's work does not comply with PCAOB standards. Thus, when the engagement partner for the principal auditor receives information about part of an entity's financial statements through documentation about the audit work of another independent auditor, he or she may not abandon "an attitude that includes a questioning mind and a critical assessment of" the audit evidence that they receive in that form and may not forego "objective evaluation" of such evidence in trying to "obtain sufficient competent evidential matter" to provide "a reasonable basis for forming an opinion" on the entity's financial statements as a whole. *E.g.*, AU §§ 230.07, 326.22.

Nor, for example, may the engagement partner for the principal auditor simply deflect to the other auditor all responsibility for any matter that raises substantial doubt about a financial statement assertion of material significance (AU § 326). Nothing in AU § 543 absolves that engagement partner from taking appropriate steps as necessary to meaningfully understand and appropriately address information relating to significant audit issues of which he or she is aware in the other auditor's work. Taking such steps is contemplated by AU § 543.13 itself, for example, which states that the principal

^{1/} *E.g.*, AU §§ 543.01 & .04 (where reference not made to other auditor's work, principal auditor exercises "professional judgment[]" about whether to use that work based not only on "the independence and professional reputation of the other auditor (see paragraph .10)" but also on "tak[ing] steps he considers appropriate to satisfy himself as to the audit performed by the other auditor (see paragraph .12)"); § 543.12 (principal auditor must review certain information from other auditor, including an engagement completion document identifying "all significant findings or issues," such as "[c]ircumstances that cause significant difficulty in applying auditing procedures" (Auditing Standard No. 3 ¶¶ 12 & 13), and information relating to significant findings or issues that are "inconsistent with or contradict the auditor's final conclusions," and "[i]n addition," "should consider performing one or more" specified procedures related to obtaining a more detailed understanding of the other auditor's work).

auditor “may consider it appropriate” to “make supplemental tests” of financial statement accounts that are assigned to the other auditor and that “[t]he determination of the extent of additional procedures, if any, to be applied rests with the principal auditor alone in the exercise of his professional judgment and in no way constitutes a reflection on the adequacy of the other auditor’s work.” In addition, AU § 543.10 provides that the principal auditor “should adopt appropriate measures to assure the coordination of his activities with those of the other auditor in order to achieve a proper review of matters affecting the consolidating or combining of accounts in the financial statements,” and various other standards may bear on what is “appropriate” in that regard.^{2/}

To the extent anything in the initial decision might suggest a contrary interpretation of AU § 543 on these larger points, we reject it.

Accordingly, it is ORDERED that Ron Freund is censured.

Effective Date of Sanctions: If Respondent does not file an application for review by the Securities and Exchange Commission (Commission) and the Commission does not order review of the sanction on its own motion, the effective date of the sanction shall be the later of the expiration of the time period for filing an application for Commission review or the expiration of the time period for the Commission to order review. If Respondent files an application for review by the Commission or the Commission orders review of the sanction, the effective date of the sanction shall be the date the Commission lifts the stay imposed by Section 105(e) of the Sarbanes-Oxley Act of 2002.

By the Board (Board Member
Ferguson not participating).



Phoebe W. Brown
Secretary

January 26, 2015

^{2/} Our discussion here quotes language and employs citations of standards in place at the time of the conduct at issue in this proceeding. Since that time, the Board has issued new standards that supersede or amend some of the standards quoted or cited in this order. The principles discussed here also apply to audits conducted under current PCAOB standards.