

ORDER

Respondent consents to entry of this Order Making Findings and Imposing Sanctions ("Order") as set forth below.

III.

On the basis of Respondent's Offer, the Board finds^{2/} that:

A. Respondent

1. Thomas J. Linden, 46, of Western Springs, Illinois, is a certified public accountant licensed in Illinois (license no. 065023618). At all relevant times, he was a partner in the Chicago, Illinois office of the registered public accounting firm of Deloitte & Touche LLP ("Deloitte") and 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).

B. Summary

2. This matter concerns Respondent's violations of PCAOB rules and professional standards in connection with Deloitte's audits of the FY 2003 financial statements of Navistar Financial Corporation ("NFC") and its ultimate parent, Navistar International Corporation ("NIC"). This conduct occurred in the context of NFC's discovery—shortly before NFC and NIC planned to file their Forms 10-K—of approximately \$19.7 million of apparent errors resulting in an overstatement of NFC's assets, revenues, and earnings (the "overstatement"). NIC had already publicly announced its fourth-quarter earnings when the overstatement was discovered. Because NFC's financial results were consolidated into NIC's financial statements,

^{2/} The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding. The sanctions that the Board is imposing 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 Respondent's conduct described in this Order meets the conditions 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.

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correction of the overstatement created the prospect that NIC would have to revise its previously-announced earnings.

3. Respondent helped NIC avoid the possibility of a revision of its reported results and assisted NIC and NFC to meet their internal deadline for filing their Forms 10-K. Upon learning of the overstatement, Respondent (1) initiated an increase of approximately 50 percent in Deloitte's planned tolerance for misstatements in NFC's reported financial results (an increase that the NFC engagement partner adopted); (2) authored, with the assistance of a member of the NFC engagement team, an NFC audit work paper that inaccurately characterized the reasons for and circumstances surrounding the increase; (3) failed to evaluate adequately the risk that NIC's financial statements were materially misstated due to error or fraud; and (4) otherwise failed to act with the requisite due professional care and professional skepticism.

C. Respondent Failed to Comply with PCAOB Auditing Standards in Connection With the FY 2003 NIC and NFC Audits

4. NIC is a Delaware corporation with principal executive offices in Warrenville, Illinois. NIC is a holding company with several operating subsidiaries, including NFC. Truck and engine manufacturing represents the majority of NIC's business activities. NIC, whose common stock is registered under Section 12(b) of the Securities Act of 1934, is an "issuer" as defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). At the time of the events described in this Order, Deloitte (and its predecessor firms) had served as the outside auditor for NIC (and its corporate predecessors) for nearly a century. The Audit Committee of NIC's Board of Directors dismissed Deloitte as its outside auditor in April 2006.

5. NFC is a Delaware corporation with principal executive offices in Schaumburg, Illinois. NFC issues debt securities in the public markets and is required to file reports under Section 15(d) of the Securities Exchange Act of 1934. At all relevant times, NFC was an "issuer" as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). NFC, a second-tier, wholly-owned subsidiary of NIC, provided financing for new and used trucks sold by another NIC subsidiary and its dealers. Part of NFC's business included securitizing and selling loans and leases through special purpose entities, which then issued securities to investors. NFC retained interests in, and continued to service, the securitized loans and leases.



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6. Respondent began working on the NIC audit engagement in 1994. He became the lead engagement partner and Lead Client Service Partner for the NIC engagement in 1997 and remained in those roles through completion of the FY 2003 audit, when he rotated off the engagement. In an audit report dated December 18, 2003, and included in NIC's Form 10-K filed with the Securities and Exchange Commission (the "Commission") on December 19, 2003, Deloitte expressed an unqualified opinion on NIC's statements of consolidated financial condition as of October 31, 2003 and October 31, 2002, and the related statements of consolidated income, comprehensive income, and cash flow for each of the three years in the period ended October 31, 2003. Deloitte's audit report stated that the audit had been conducted in accordance with U.S. generally accepted auditing standards^{3/} and that, in Deloitte's opinion, NIC's financial statements presented fairly, in all material respects, its financial position in conformity with U.S. generally accepted accounting principles ("GAAP"). Respondent had final responsibility for the NIC audit as that phrase is used in AU § 311, *Planning and Supervision*, and authorized issuance of the audit report on December 18, 2003, concurrent with Deloitte's issuance of the NFC FY 2003 audit report. During the final days of the FY 2003 audit, Respondent also performed certain procedures in the NFC audit as described in this Order, although he was not a member of Deloitte's engagement team for the NFC audit (the "NFC engagement team").

7. In connection with the preparation or issuance of an audit report, PCAOB rules require that associated persons of registered public accounting firms comply with the Board's auditing standards.^{4/} Under these standards, an auditor may express an

^{3/} Deloitte's FY 2003 audit reports for NIC and NFC stated that the audits were conducted in accordance with generally accepted auditing standards in the United States of America ("GAAS"). Respondent was required to conduct the audits in accordance with the PCAOB's interim auditing standards pursuant to PCAOB Rule 3200T, which took effect on April 25, 2003. However, at the time of the FY 2003 NIC and NFC audits, the PCAOB's interim auditing standards were the same as GAAS as it existed on April 16, 2003, and, until PCAOB Auditing Standard No. 1 took effect on May 24, 2004, it remained appropriate for auditors to refer to GAAS in their audit reports. Accordingly, although the references to GAAS in Deloitte's reports for NIC and NFC were appropriate at the time, the standards pursuant to which the audits were required to be performed are more appropriately referred to as PCAOB auditing standards (or PCAOB standards), and that is how they are referred to in this Order.

^{4/} See PCAOB Rules 3100, 3200T.

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unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.^{5/} Among other things, those standards require that an auditor exercise due professional care, maintain professional skepticism, and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements.^{6/} Under PCAOB standards, representations from management are part of the evidential matter that an auditor obtains, but management representations are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for the auditor's opinion.^{7/} PCAOB standards also provide that when information comes to an auditor's attention that differs significantly from the information on which the audit plan was based, the auditor may need to re-evaluate his or her audit procedures based on a revised consideration of audit risk and materiality.^{8/} Respondent failed to comply with these standards in connection with the FY 2003 audits of NIC and NFC.

NIC's Earnings Announcement

8. By early December 2003, the Deloitte engagement teams' field work on the NIC and NFC audits was substantially complete and NIC management prepared to publicly announce its fourth-quarter and year-end results. Respondent knew that NIC routinely communicated with securities analysts at the end of each reporting period to discuss the company's financial and operating results and to provide earnings guidance for future periods. On December 1, 2003, Respondent attended a telephonic meeting of NIC's Audit Committee during which NIC's fourth-quarter and year-end results were reviewed in anticipation of an upcoming conference call with analysts and a public release on Form 8-K. He informed the Audit Committee at that time that Deloitte had substantially completed its audit and expected to issue an unqualified report.

^{5/} See AU § 508.07, *Reports on Audited Financial Statements*.

^{6/} See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230, *Due Professional Care in the Performance of Work*; AU § 326, *Evidential Matter*.

^{7/} See AU § 333, *Management Representations*.

^{8/} See AU § 312, *Audit Risk and Materiality in Conducting an Audit*.

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9. On December 2, 2003, NIC management hosted a conference call with securities analysts to announce, among other things, NIC's fourth-quarter and year-end results. NIC informed analysts that its fourth-quarter net income from continuing operations, when adjusted for restructuring costs, was \$0.72 per share. NIC management noted that these results were "on the top side of the previous guidance we had provided" to the public at the end of the third quarter.^{9/} Respondent was aware of the substance of NIC's earnings announcement prior to the completion of the NIC and NFC audits.

Audit Committee Communication

10. On December 8, 2003, Respondent informed the Audit Committee that Deloitte's FY 2003 audit of NIC's consolidated financial statements was substantially complete. At that time, Respondent expected that the Deloitte audit reports would be issued and NIC's and NFC's Forms 10-K would be filed with the Commission on December 18, 2003. This expectation was consistent with the companies' past practice of filing their Forms 10-K with the Commission before the Christmas holiday, several weeks in advance of the regulatory deadline (which fell on January 29, 2004 for the FY 2003 financial statements).

Discovery of Overstated Balances

11. Although Respondent's December 8, 2003 Audit Committee communication indicated that the audit of NIC's consolidated financial statements was substantially complete, the NFC engagement team was still awaiting NFC's reconciliation of suspense accounts used to account for cash disbursements and collections related to NFC's securitization transactions.

12. On the evening of December 16, 2003, the NFC engagement partner advised Respondent that the ongoing suspense account reconciliations had revealed potential overstatements in the balances of certain accounts. The NFC engagement team had been advised by NFC management that cash outlays totaling approximately \$17.7 million had not been appropriately recorded, and an asset, now worthless, was recorded on NFC's books at approximately \$2.0 million. These apparent errors resulted

^{9/} In August 2003, NIC management had informed analysts that "[w]e anticipate we will be solidly profitable in the fourth quarter with diluted earnings of between \$0.65 and \$0.75 per share from continuing operations."

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in an overstatement of NFC's assets, revenue, and earnings, according to an NFC audit work paper.

NFC's Accounting Decisions and Adjustments

13. Following discovery of the overstatement, NFC made a series of accounting decisions on December 17 and 18 that had the net result of avoiding any impact on NIC's reported earnings. First, NFC identified rationales for writing off less than half of the overstatement in 2003. Second, through recalculations of estimated securitization gains, NFC identified purported additional gains that offset those write-offs.

14. Accordingly, in financial statements filed with NFC's Form 10-K on December 19, 2003, the effect of the overstatement, including any potential impact on NIC's reported earnings, was neutralized.

Respondent's Knowledge of NFC's Accounting Decisions and Adjustments

15. Respondent knew, following the discovery of the overstatement, that NFC and NIC executives had a "certain level of anxiety" concerning the potential size of the overstatement and that NIC management would prefer not to revise its announced earnings. And he knew that both NIC and NFC executives attended and participated in meetings related to the overstatement.

16. By the time he authorized issuance of Deloitte's audit report for NIC on or about December 18, 2003, Respondent knew that NFC had made adjustments to its FY 2003 gain calculations that had the effect of neutralizing the write-offs made in connection with the discovery of the overstatement. An analysis prepared by the NFC engagement partner, and transmitted to Respondent on December 18, showed a \$7.294 million write-off and an offsetting \$7.294 million increase from additional gains related to NFC's FY 2003 securitization transactions.

17. Respondent also knew that NFC postponed the write-off of \$4.5 million of the overstatement to the first-quarter of FY 2004, without identifying a sufficient basis under GAAP to do so. And he knew that in recalculating its securitization gains, NFC rounded certain figures to the nearest million dollars. The NFC engagement partner told Respondent in an email that the rounding resulted in a \$1.5 million overstatement in the recalculated gains.



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Respondent's Auditing Failures

18. Under the circumstances described above, an auditor proceeding in compliance with PCAOB standards would recognize the need to consider whether the company's last-minute adjustments called for the auditor to revise his assessment of the risk of material misstatement due to fraud,^{10/} or otherwise to reconsider the nature, timing, or extent of audit procedures^{11/} in order to obtain the appropriate level of assurance concerning the financial statements. More generally, the due professional care required by PCAOB standards includes the element of professional skepticism, which is "an attitude that includes a questioning mind and a critical assessment of audit evidence" and an unwillingness to "be satisfied with less than persuasive evidence."^{12/}

^{10/} PCAOB standards require an auditor, without making assumptions about whether management is honest or dishonest (see AU § 230.09), to respond to certain events—including "last-minute adjustments by the entity that significantly affect financial results" and "undue time pressures imposed by management to resolve complex or contentious issues"—by factoring them into an objective assessment of the risk of material misstatement due to fraud. See AU § 316.68, *Consideration of Fraud in a Financial Statement Audit*. (In the predecessor version of AU § 316, which was in effect for the audits of NFC's and NIC's FY 2003 financial statements, the corresponding provision is found at ¶ 25, rather than ¶ 68. See AU § 316A.25.)

^{11/} Faced with factors suggesting an increased risk of material misstatement due to fraud, the application of appropriate professional skepticism involves such things as considering the need for additional procedures and additional corroboration of management's explanations or representations. See AU § 316.46. (In the predecessor version of AU § 316, which was in effect for the audits of NFC's and NIC's FY 2003 financial statements, the corresponding provision is found at ¶ 27, rather than ¶ 46. See AU § 316A.27.) Even apart from any risk of misstatement due to fraud, when information comes to an auditor's attention that differs significantly from the information on which the audit plan was based, the auditor may need to re-evaluate his or her audit procedures based on a revised consideration of audit risk and materiality. See AU § 312.33, *Audit Risk and Materiality in Conducting an Audit*.

^{12/} See AU §§ 230.07, 230.09.

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19. Following the December 16, 2003 discovery of the overstatement, however, Respondent failed to comply with these standards in connection with his role in the NFC and NIC audits. Although he was the engagement partner for the NIC audit, after the overstatement was discovered, Respondent initiated, and the NFC engagement partner adopted, an increase in Deloitte's planned tolerance for error in the NFC audit. Respondent also authored, with the assistance of a member of the NFC engagement team, an NFC work paper that inaccurately characterized the reasons for and circumstances surrounding the increase. And he failed to assess with due care and professional skepticism the risk that NIC's financial statements were materially misstated due to error or fraud.

The Increase in NFC's Planning Materiality

20. In planning the FY 2003 audit for NFC, the NFC engagement partner had set, at pre-tax income of \$4.1 million, the quantitative threshold to be used to determine, among other things, whether to treat a misstatement in NFC's financial statements as presumptively material. The NFC engagement partner had used the same 5 percent threshold, known as the "planning materiality" threshold, in all four of his years as the engagement partner for the NFC audit. In those four years, Respondent had no involvement in setting planning materiality for NFC.

21. The morning after the discovery of the overstatement, however, Respondent reviewed the planning materiality threshold that the NFC engagement partner had set. He then initiated, and the NFC engagement partner adopted, an increase to 7.5 percent of pre-tax income, or \$6.1 million, thus effectively raising by 50 percent a key benchmark used to help determine how much error would be tolerated in NFC's financial statements. The increase to the materiality threshold made it easier for NFC to avoid correction of misstatements associated with the overstatement.

Respondent's Documentation of The Planning Materiality Increase

22. The increase in NFC's planning materiality threshold was documented in a December 17, 2003 memorandum from Respondent to the NFC audit files (the "materiality memo"). The materiality memo stated that "NFC's materiality calculation for 2003 was not calculated in a manner that was consistent with its parent – NIC and [did not] properly incorporate[] all of the right qualitative factors." However, there is no requirement that materiality for a manufacturing parent and a wholly-owned financial

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services subsidiary be calculated in a consistent manner.^{13/} Planning materiality was increased to make it easier to issue an unqualified audit opinion despite known misstatements in NFC's financial statements.

23. The materiality memo also included certain supporting detail that did not accurately characterize the circumstances in which Respondent initiated the increase of NFC's planning materiality. Specifically, the materiality memo stated: "During our year end audit summary process, I reviewed the materiality calculations of all of the subsidiaries of [NIC] including Navistar Financial Corporation (NFC) to ensure consistency with the materiality used for the parent company and to provide concurrence as to the calculated amounts." In fact, it was the discovery of the overstatement, not the year-end audit summary process, that led Respondent to review NFC's planning materiality.

The Effect of the Increased Planning Materiality

24. The increased materiality threshold affected the NFC engagement team's assessment of the approximately \$4.5 million component of the overstatement. Respondent understood that NFC intended to postpone the write-off of that \$4.5 million to FY 2004, rather than take the write-off in FY 2003. Respondent also knew that, if the original \$4.1 million materiality threshold were applied, the NFC engagement partner would have been required by Deloitte's internal guidance to treat that \$4.5 million unadjusted audit difference as presumptively material to NFC's financial statements.^{14/} Applying the 50 percent higher threshold, however, enabled the NFC engagement team to treat the \$4.5 million as presumptively immaterial on a quantitative basis under Deloitte's internal guidance.

^{13/} PCAOB standards provide that materiality assessments should "vary with the size and complexity of the entity" and take into account "[c]ertain entity-related factors." AU § 312.15.

^{14/} Deloitte's internal guidance concerning evaluation of misstatements provided, in part: "If known misstatements (net of tax effects, if applicable), either individually or in the aggregate, exceed planning materiality, we generally conclude that the financial statements are materially misstated. In such event, the client needs to adjust some or all of the known misstatements until we can conclude that aggregate unadjusted misstatements are acceptably small."

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Respondent's Approach to Materiality at NIC

25. Because NFC's financial results were consolidated into NIC's, Respondent was required to evaluate whether any misstatements identified in NFC's financial statements were material to NIC's financial statements. PCAOB standards provide that, "[i]n evaluating the effects of misstatements, the auditor should include both qualitative and quantitative considerations."^{15/} In determining whether an unadjusted amount in dispute with management is qualitatively material, PCAOB standards identify certain factors as relevant, including:

- "[t]he sensitivity of the circumstances surrounding the misstatement;"
- "[t]he effect of misstatements of earnings when contrasted with expectations;"
- "[t]he motivation of management;"
- "[t]he existence of offsetting effects of individually significant but different misstatements;" and
- "[t]he risk that possible additional undetected misstatements would affect the auditor's evaluation."^{16/}

26. Related guidance similarly advises the auditor to consider whether management might be improperly refusing to take a write-off to avoid a charge to reported earnings.^{17/} Specifically, that guidance: (a) provides that it is "unlikely that it is ever 'reasonable' . . . not to correct known misstatements—even immaterial ones—as

^{15/} AU § 312.34.

^{16/} AU § 9312.17g., j., l., m., p., *Audit Risk and Materiality in Conducting an Audit: Auditing Interpretations of Section 312*.

^{17/} See Commission Staff Accounting Bulletin No. 99, *Materiality* ("SAB 99"); Practice Alert 94-1 (AICPA SEC Practice Section Professional Issues Task Force), *Dealing With Audit Differences*.

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part of an ongoing effort directed by or known to senior management for the purposes of 'managing' earnings;"^{18/} and (b) advises auditors that they "should exercise great care when netting 'hard' . . . differences [i.e., known errors] and 'soft' . . . differences [i.e., differences based on estimates]," especially when the netting is done at the "[l]ast-minute."^{19/}

27. In evaluating whether NIC's financial statements were free from material misstatement, Respondent failed sufficiently to assess the qualitative factors discussed above. At the time of his assessment, Respondent understood that (1) NFC had offset any overstatement-related write-offs by recalculating its securitization gains; (2) NFC had rounded certain figures to the nearest million dollars in recalculating those gains, thereby increasing the recalculated gains by \$1.5 million; (3) NFC and NIC had not provided a sufficient basis under GAAP to delay the write-off of \$4.5 million of the overstatement; (4) NIC and NFC executives had a "certain level of anxiety" concerning the potential size of the NFC overstatement; (5) NIC management preferred not to revise its announced earnings; and (6) a public company's stock price can be affected when projected earnings are missed. Under the circumstances, Respondent did not obtain reasonable assurance that NIC's financial statements were free from material misstatement due to error or fraud.

IV.

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

- A. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Thomas J. Linden is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);

^{18/} SAB 99.

^{19/} Practice Alert 94-1, *Dealing With Audit Differences*, ¶ .03.

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- B. After two (2) years from the date of this Order, Thomas J. Linden may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm; and
- C. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of \$75,000 is imposed. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Thomas J. Linden shall pay this civil money penalty within 10 days of the issuance of this Order by (a) United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Public Company Accounting Oversight Board; (c) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006; and (d) submitted under a cover letter which identifies Thomas J. Linden as a respondent in these proceedings, sets forth the title and PCAOB Release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: J. Gordon Seymour, General Counsel and Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006.

ISSUED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

August 11, 2009