

ORDER

Respondent consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.¹

III.

On the basis of Respondent's Offer, the Board finds that:²

A. Respondent

1. Wayne J. Kaplan, age 52, of Ambler, Pennsylvania, is a certified public accountant licensed by the Pennsylvania State Board of Accountancy (license no. CA028606L) and the New Jersey State Board of Accountancy (license no. 20CC03104600). Kaplan has been a partner at Grant Thornton LLP ("Grant Thornton" or "GT") since 1995, and was the office managing partner of GT's Philadelphia office from August 2011 through July 2014. Kaplan served as the engagement quality reviewer on Grant Thornton's integrated audits of the December 31, 2012 and 2013 financial statements and ICFR of Issuer A. Kaplan, as the engagement quality reviewer, provided his concurring approval of the issuance of Grant Thornton's March 3, 2014 audit report containing an unqualified opinion on Issuer A's December 31, 2013 financial statements and ICFR. At all relevant times, Kaplan was an audit partner in the Philadelphia office of Grant Thornton and an associated person of a registered public accounting firm as that term is defined by Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

B. Relevant Entities

2. Grant Thornton LLP is a limited liability partnership organized under the laws of the state of Illinois, and headquartered in Chicago, Illinois. Grant Thornton registered with the Board on September 24, 2003, pursuant to Section 102 of the Act and PCAOB rules. Grant Thornton has served as Issuer A's independent auditor since Issuer A's inception in 2005.

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other persons or entities in this or any other proceeding.

² The Board finds that Respondent's conduct described in this Order meets the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5), which provides that certain sanctions may be imposed in the event of: (1) intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard; or (2) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

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3. Issuer A is a Maryland corporation with headquarters in New York, New York. Issuer A is a diversified real estate finance company that is organized and conducts its operations to qualify as a REIT. Issuer A's investment strategy focuses on commercial real estate, commercial real estate-related assets, and, to a lesser extent, commercial finance assets. At all relevant times, Issuer A's common stock was registered under Section 12(b) of the Securities Exchange Act of 1934 and was traded on the NYSE. At all relevant times, Issuer A was an "issuer" as the term is defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

C. Summary

4. This matter concerns Kaplan's violations of PCAOB rules and auditing standards in connection with the audit of Issuer A's December 31, 2013 financial statements and ICFR ("2013 audit"). Specifically, Kaplan failed to comply with Auditing Standard No. 7, *Engagement Quality Review* ("AS 7") and failed to exercise due professional care, including appropriate professional skepticism, in his performance of the engagement quality review of the 2013 Issuer A audit.³ Kaplan failed to properly evaluate (a) the engagement team's assessment of, and audit responses to, significant risks, including fraud risks; and (b) whether the engagement documentation indicated the engagement team responded appropriately to significant risks and supported the conclusions reached by the engagement team.

5. As a result of his failure to perform the engagement quality review with due professional care in conformity with PCAOB standards, Kaplan lacked an appropriate basis to provide his concurring approval of issuance of Grant Thornton's unqualified opinion on Issuer A's 2013 financial statements and ICFR.

6. Kaplan did not perform the engagement quality review with due professional care despite being on notice that Richard Huff, the engagement partner on the 2013 Issuer A audit, had significant quality issues dating back several years.⁴ Because of issues including Huff's known quality problems, Grant Thornton, with Kaplan's input, placed Huff on a Partner Performance Plan ("Performance Plan") in June 2013, which mandated, among other things, that Huff take certain steps to

³ All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the relevant audit or review. As of December 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015); *see also PCAOB Auditing Standards Reorganized and Pre-Reorganized Numbering* (January 2017).

⁴ *See Richard H. Huff, Jr., CPA*, PCAOB Rel. No. 105-2019-001 (Feb. 26, 2019); *see also Grant Thornton LLP*, PCAOB Rel. No. 105-2017-054 (Dec. 19, 2017).

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improve his performance. Kaplan was also aware that an internal GT review team concluded that the 2012 Issuer A audit failed to comply with PCAOB standards, and that Kaplan, as engagement quality reviewer, failed to conduct an appropriate engagement quality review. Despite having this understanding regarding Huff's quality issues and findings about his own work in the prior year, at the time of his 2013 review Kaplan failed to adjust the procedures he performed to reflect the risks associated with the 2013 Issuer A audit.

D. Background

7. As of December 31, 2013, Issuer A reported total assets of \$2.2 billion, including \$1.4 billion in loans. Commercial real estate ("CRE") loans comprised \$826 million or 59% of Issuer A's loan portfolio. Issuer A maintained an allowance for loan losses ("ALL") to cover probable losses that existed in the loan portfolio as of each period end. Issuer A's ALL for bank and CRE loans comprised two components, specific reserves based on estimated losses on individually reviewed impaired loans and a general loss reserve for non-impaired loans. GT's work papers also indicated that Issuer A relied on its loan review process, at least in part, to identify impaired loans, calculate specific reserves, and assess the sufficiency of its ALL.

8. Issuer A's impaired loans totaled \$204 million or 9 percent of Issuer A's reported total assets at December 31, 2013. Impaired CRE loans comprised \$194 million or 95% of total impaired loans. Issuer A reported an ALL of \$13.8 million as of December 31, 2013, of which Issuer A allocated \$10.4 million to CRE loans. The \$10.4 million in ALL allocated to CRE loans included \$4.6 million in specific reserves.

9. Before the 2013 Issuer A audit, Kaplan was aware that Huff had a history of poor quality audits. Indeed, Huff served as engagement partner for four issuer audits during 2008 through 2011 that the PCAOB inspected between 2009 and 2012. In all four, the PCAOB inspections staff found deficiencies of such significance that it appeared those audits were not supported by sufficient appropriate audit evidence. Kaplan was also aware that Huff had received negative quality indicators on his annual quality report based on his lack of professional skepticism and had also been reminded in his partner scorecards of his need to be more involved in his audit engagements and to be more skeptical of his clients. In January 2013, Kaplan and others at Grant Thornton considered removing Huff from his public and private bank and credit union clients. They did so, in part, due to concerns about the quality of Huff's audit work.

10. Grant Thornton, in response to audit quality concerns with Huff, including the PCAOB inspection results, placed Huff on a Performance Plan in mid-2013. The terms of the Performance Plan were determined by Kaplan in consultation with GT's national office. Under the terms of the Performance Plan, Huff could be removed from the partnership if he failed to show sufficient progress in, among other things, improving the quality of his audit work.

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11. Shortly after the Performance Plan took effect, the Firm selected the 2012 Issuer A audit, for which Huff served as engagement partner, for an Audit Practice Review ("2013 APR"), which is an internal review during which a separate GT team reviews the audit work papers to determine whether the engagement team complied with GT's policies and professional standards. The APR team identified numerous deficiencies in the audit, including with respect to ICFR, and ultimately concluded that the 2012 Issuer A audit was noncompliant with Firm policies and PCAOB standards. The APR team also concluded that Kaplan failed to conduct an appropriate engagement quality review.

E. Applicable PCAOB Rules and Auditing Standards

12. PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards.⁵ AS 7 required GT to perform an engagement quality review and obtain a concurring approval of issuance of its audit opinion on the 2013 Issuer A audit.⁶

13. Under AS 7, the engagement quality reviewer may provide concurring approval of issuance for an audit report only if, after performing with due professional care the review required by AS 7, he or she is not aware of a significant engagement deficiency.⁷ To perform an engagement quality review with due professional care, the engagement quality reviewer must exercise sufficient professional skepticism under the circumstances.⁸

14. An engagement quality reviewer should evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.⁹ In performing an engagement quality review for an audit, the engagement quality review

⁵ See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

⁶ AS 7 ¶ 1.

⁷ AS 7 ¶ 12. A significant engagement deficiency in an audit exists when: "(1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client." *Id.*, Note.

⁸ See AU § 230.07-09.

⁹ AS 7 ¶ 9.

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should, among other things, evaluate the engagement team's assessment of, and audit responses to, significant risks, including fraud risks, identified by the engagement team or other significant risks identified by the engagement quality reviewer.¹⁰ The engagement quality reviewer should also evaluate whether the engagement documentation that he or she reviewed indicates that the engagement team responded appropriately to significant risks and whether the engagement documentation that he or she reviewed supports the conclusions reached by the engagement team with respect to matters reviewed.¹¹

15. As described below, Kaplan violated these PCAOB auditing standards in connection with his engagement quality review on the 2013 Issuer A audit because he failed to perform a "rigorous review" that provided "a meaningful check on the work performed by the engagement team."¹² Moreover, the engagement quality reviewer may provide concurring approval of issuance for an audit report only if, after performing with due professional care the review required by AS 7, he or she is not aware of a significant engagement deficiency.¹³ AS 7 states that a "significant engagement deficiency in an audit exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client."¹⁴ As described below, Kaplan failed to comply with the above PCAOB rules and standards in connection with the 2013 Issuer A audit.

F. Kaplan Violated PCAOB Rules and Auditing Standards in Connection with GT's Audit of Issuer A's 2013 Financial Statements

16. In performing his review of the 2013 Issuer A audit, Kaplan failed to adequately: (a) evaluate the engagement team's assessment of significant risks, including fraud risks; (b) evaluate the engagement team's audit responses to the significant risks the team had identified; and (c) evaluate whether the engagement documentation that he reviewed supported the conclusions reached by the engagement team.

¹⁰ AS 7 ¶ 10b.

¹¹ AS 7 ¶ 11.

¹² See PCAOB Release No. 2009-004 (July 28, 2009) at 19.

¹³ See AS 7 ¶ 12.

¹⁴ See AS 7 ¶ 12, Note.

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17. Kaplan provided his concurring approval of issuance for the audit without performing the engagement quality review with due professional care in violation of AS 7. Kaplan, despite being aware that the APR team had concluded that the 2012 Issuer A audit failed to comply with PCAOB standards, including his own engagement quality review, failed to increase the scope and depth of his engagement quality review and failed to take steps to confirm that the prior year significant engagement deficiencies were addressed in the 2013 audit approach.

Kaplan failed to adequately evaluate the engagement team's assessment of significant risks, including fraud risks

18. Kaplan, as engagement quality reviewer, was required to evaluate whether the engagement team properly assessed significant risks, including fraud risks.¹⁵ Despite this requirement, Kaplan failed to review sufficient work papers to evaluate the foundation of the engagement team's risk assessment process, including the identification of significant risks and fraud risks, and its planned audit approach. Among the risk assessment related work papers that Kaplan failed to review were the Key Control Summary, Prior Year Significant Deficiencies Memo, Auditing Accounting Estimates Work Book, various Estimates Templates, What Could Go Wrong Work Paper, and Audit Approach Summary.

19. Kaplan also did not attend the Approval of Audit Approach Meeting for the 2013 audit, the end product of which was meant to be the agreement by the engagement partner and the engagement quality reviewer to the planned audit approach, or otherwise hold discussions with the audit team. The purpose of that meeting was to do a "deep-dive into the audit strategy, risk assessments, and related responses" and was "intended to include an in-depth, meaningful dialogue of the audit, accounting, and reporting issues related to the engagement."

20. Through his failure to sufficiently review key risk assessment related work papers and his failure to hold sufficient discussions with the audit team, Kaplan was left without an appropriate basis to evaluate the engagement team's assessment of significant risks and did not exercise due professional care. Accordingly, Kaplan provided his concurring approval of issuance for the audit without performing the engagement quality review with due professional care, in violation of AS 7.¹⁶

¹⁵ See AS 7 ¶ 10. To do so, the engagement quality reviewer should hold discussions with the engagement team and review documentation to evaluate the engagement team's judgments and conclusions. See AS 7 ¶ 9.

¹⁶ See AS 7 ¶ 12.

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Kaplan failed to evaluate the engagement team's responses to significant risks, including fraud risks

21. PCAOB standards also required that Kaplan evaluate the engagement team's responses to significant risks identified during the engagement team's risk assessment process.¹⁷ The engagement team identified significant risks associated with the valuation of investments priced with models or similar techniques and the ALL, as well as fraud risks related to rental income, interest income on loans, and interest income on investments. Accordingly, Kaplan was required to assess the engagement team's audit response to each of those risks.

22. On the 2013 Issuer A audit, Kaplan failed to sufficiently evaluate the engagement team's audit responses to those significant risks. Indeed, Kaplan failed to understand how the engagement team addressed those risks, including by failing to sufficiently assess the team's tests of controls for any of the significant risks, including fraud risks, identified by the engagement team. Among other things, Kaplan provided his concurring approval of issuance of the audit reports without reviewing test of controls work papers, or other relevant audit documentation, related to the known significant risks.

23. Kaplan's failure to sufficiently evaluate the team's test of controls, was compounded by his decision to review a narrow set of substantive work papers related to those significant risks and fraud risks. For example, the engagement team's planned response to address the significant risk associated with the ALL was to perform substantive loan reviews. Kaplan, however, failed to review the work paper documenting the engagement team's approach to selecting CRE loans for review and reviewed only two of the substantive loan reviews performed by the engagement team on CRE loans.¹⁸ Because Kaplan failed to review the work paper setting forth the engagement team's approach to selecting loans for review, or other relevant audit documentation, he failed to discover that the engagement team did not make an appropriate selection of loans to test.¹⁹

24. Because Kaplan failed to review additional loan reviews, or other relevant audit documentation, he failed to discover that the engagement team did not

¹⁷ See AS 7 ¶ 10b.

¹⁸ Significantly, Kaplan – who was aware or should have been aware that a significant percentage of the CRE loans originated before the financial crisis presented an increased risk – reviewed only one substantive loan review performed on such a "legacy loan."

¹⁹ See *Richard H. Huff, Jr., CPA*, PCAOB Rel. No. 105-2019-001 (Feb. 26, 2019).

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appropriately (i) identify and evaluate potential control deficiencies; (ii) address red flags indicating that risk ratings might have been inappropriate and/or that specific reserves may have been required; and (iii) obtain relevant and reliable evidence to corroborate management's representations.

25. Kaplan also failed to review the engagement team's work papers documenting its substantive impairment test work over impaired loans that it had selected. Because Kaplan failed to review the test work, or other relevant audit documentation, he failed to discover that the engagement team did not properly evaluate the reasonableness of the specific reserves against the loans in those relationships, and failed to discover that the engagement team had not sufficiently addressed contrary audit evidence. In fact, Kaplan failed to discover that the engagement team had failed to assess whether it had obtained an impairment calculation from Issuer A that complied with Generally Accepted Accounting Principles and whether the team appropriately assessed whether Issuer A's controls over the calculation of impairment were designed and operating effectively.

26. Kaplan also failed to review any work papers documenting the engagement team's substantive procedures over the identification of TDRs within the CRE loan portfolio.

27. The limited scope of Kaplan's work paper review did not provide him with a sufficient basis to evaluate the reasonableness of the engagement team's responses to significant risks. Accordingly, Kaplan provided his concurring approval of issuance for the audit without performing the EQR with due professional care, in violation of AS 7.²⁰

Kaplan failed to properly evaluate whether the engagement documentation supported the engagement team's conclusions

28. PCAOB standards require an engagement quality reviewer to evaluate whether the documentation that he or she reviewed indicates that the engagement team responded appropriately to significant risks and whether it supports the conclusions reached by the engagement team.²¹ Kaplan violated PCAOB standards because he failed to properly evaluate whether the limited number of work papers he did review responded appropriately to significant risks and whether they supported the engagement team's conclusions.

29. For example, Kaplan reviewed one of the legacy loans selected for loan review. The purpose of that loan review was to test Issuer A's process for assigning risk ratings, its ability to timely identify impaired loans, including TDRs, its ability to

²⁰ See AS 7 ¶ 12.

²¹ AS 7 ¶ 11.

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appropriately calculate specific reserves, and its ability to timely recognize charge-offs. On the face of the work papers Kaplan reviewed, it was clear, however, that the loan relationship was already classified as impaired by virtue of its designation as a TDR. Accordingly, the biggest risk associated with the loan that Kaplan reviewed was that the specific reserve was inadequate. The loan review, however, failed to properly assess whether specific reserves were required.

30. Kaplan provided his concurring approval of issuance without evaluating whether the audit documentation, with respect to the one loan he reviewed, supported the engagement team's conclusion that no specific reserve was required and that the risk rating was appropriate. Based on his limited work paper review, Kaplan failed to identify significant deficiencies in the engagement team's work, including its:

- failure to identify and evaluate potential control deficiencies related to, among other areas, the monitoring of collateral and the assignment of risk ratings;
- failure to properly evaluate contrary evidence or red flags indicating that the risk rating was inappropriate and/ or that specific reserves may have been required, including insufficient operations to service principal and interest payments and the use of modifications to keep loans current;²²
- failure to identify a sufficient source of repayment to support its reserves determination;
- failure to consider the impact of Issuer A's subordinated status when calculating debt service ratios and loan-to-value ratios; and
- reliance on management representations that the loans were fully collectible without obtaining relevant and reliable evidence to corroborate those representations.

31. Because the loans had already been classified as impaired and TDRs, the inclusion of the loans in the substantive loan review procedures failed to achieve two of the primary objectives of the audit procedures. Kaplan, however, failed to identify this flaw. Accordingly, to the limited extent Kaplan reviewed work papers, he failed to

²² As discussed above, Kaplan failed to review the team's work papers documenting its impairment test work, or other relevant audit documentation, and as a result, he failed to discover additional red flags and contrary evidence that the engagement team ignored or failed to respond appropriately to including, among other things, the deferral of principal and interest payments and the forced liquidation of six of the twelve properties securing the loans.

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properly evaluate whether the documentation he reviewed supported the conclusions reached by the engagement team.

IV.

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

- A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Wayne J. Kaplan, CPA, is hereby censured;
- B. Pursuant to Section 105(c)(4)(C) of the Act and PCAOB Rule 5300(a)(3), for a period of two (2) years from the date of this Order, Wayne J. Kaplan's role in any "audit," as that term is defined in Section 110(1) of the Act and PCAOB Rule 1001(a)(v), shall be restricted as follows: Kaplan shall not (a) serve, or supervise the work of another person serving, as an "engagement quality reviewer," as that term is used in AS 1220, *Engagement Quality Review*, or (b) serve, or supervise the work of another person serving, in any role that is equivalent to, but differently denominated from, engagement quality reviewer (such as "concurring partner"); and
- C. Pursuant to Section 105(c)(4)(F) of the Act and PCAOB Rule 5300(a)(6), Wayne J. Kaplan is required to complete, within one (1) year from the date of this Order, ten (10) hours of professional education and training relating to performing engagement quality reviews in accordance with AS 1220; however, Kaplan will receive credit for five (5) hours of such professional education already taken since the date of the conduct at issue but prior to the date of this Order.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

February 26, 2019