By this Order, the Public Company Accounting Oversight Board ("Board" or "PCAOB") is: (1) censuring Timothy M. Kosiek ("Kosiek" or "Respondent"); (2) barring Kosiek from being an associated person of a registered public accounting firm;¹ and (3) imposing a civil money penalty in the amount of $25,000 on Kosiek. The Board is imposing these sanctions on the basis of its findings that Kosiek violated PCAOB rules and auditing standards in connection with the integrated audit of the financial statements and internal control over financial reporting of Flagstar Bancorp, Inc., as of and for the year ended December 31, 2013.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), and PCAOB Rule 5200(a)(1) against Respondent.

II.

In anticipation of the institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent has submitted an Offer of Settlement ("Offer") that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent

¹ Kosiek may file a petition for Board consent to associate with a registered public accounting firm after two (2) years from the date of this Order.
consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions ("Order") as set forth below.2

III.

On the basis of Respondent's Offer, the Board finds3 that:

A. **Respondent**

1. Timothy M. Kosiek, CPA, 60, of Minneapolis, Minnesota, was, at all relevant times, a certified public accountant licensed by the Minnesota Board of Accountancy (license no. 13127) and a partner of the PCAOB-registered public accounting firm Baker Tilly Virchow Krause, LLP ("Baker Tilly" or "Firm"). Kosiek is, and at all relevant times was, 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).

2. From 1980 until 2000, Kosiek was an auditor at a Big Four accounting firm, eventually rising to the position of partner, with responsibilities that included the audits of financial institutions. In 2000, Kosiek left auditing to become the Chief Financial Officer of a bank holding company. He returned to auditing in 2009 when he joined Baker Tilly as a partner. Kosiek took over as the engagement partner for the Firm's audits of Flagstar Bancorp, Inc. ("Flagstar"), in 2010.

B. **Relevant Entities**

3. Baker Tilly Virchow Krause, LLP, was, at all relevant times, a limited liability partnership organized under Illinois law, and headquartered in Chicago, Illinois. The Firm is registered with the Board pursuant to Section 102 of the Act and PCAOB rules, and is licensed by the Minnesota Board of Accountancy, among others. The Firm acted as the external auditor for Flagstar for fiscal years 2005 through 2014.

4. Flagstar Bancorp, Inc., was, at all relevant times, a Michigan corporation headquartered in Troy, Michigan, and the holding company for Flagstar Bank, FSB.4

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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.

3 The Board finds that Respondent's conduct described in this Order meets the condition 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 (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.
Flagstar's common stock was registered under Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and was traded on the New York Stock Exchange under the symbol "FBC." At all relevant times, Flagstar was an issuer as that term is defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

C. Summary

5. Flagstar is one of the nation's largest mortgage originators and the largest bank in Michigan, with 99 branches statewide and a mortgage division that operates a network in all 50 states. For the year ended December 31, 2013 ("FY 2013"), Flagstar reported assets of $9.4 billion, which at the time made it one of the ten largest savings banks in the United States. Flagstar is regulated by a number of federal government agencies, including the Office of the Comptroller of the Currency ("OCC").

6. For FY 2013, Flagstar disclosed in its annual report that real estate and economic conditions could adversely affect its business, and specifically that:

"[t]here is a risk of default with respect to all of our mortgages and other loans, and our remedies to collect, foreclose or otherwise recover may not fully satisfy the debt owed to us. We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, to provide for probable and inherent losses in our loans held for our investment portfolio. Our allowance for loan losses, however, may not be adequate to cover actual credit losses, and future provisions for credit losses could adversely affect our business, financial condition, results of operations, cash flows and prospects."5

One of the most important aspects of Flagstar's accounting in FY 2013, therefore, was its allowance for loan and lease losses ("ALLL").

7. This matter concerns Kosiek's failure to comply with PCAOB rules and standards in connection with Baker Tilly's integrated audit of Flagstar's financial statements and internal control over financial reporting ("ICFR") for FY 2013. In particular, Kosiek failed to exercise due professional care, including appropriate professional skepticism, and failed to obtain sufficient appropriate audit evidence in connection with the reported value of and controls over Flagstar's ALLL for year-end 2013.

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4 Flagstar Bancorp, Inc., and Flagstar Bank, FSB, are referred to jointly in this Order as "Flagstar."

8. First, at the time of his FY 2013 audit of Flagstar ("2013 Audit"), Kosiek was in his fourth year as the engagement partner on Flagstar's audit and understood that Flagstar's ALLL was a financial statement account that presented a high risk of material misstatement. Kosiek also knew that one of Flagstar's principal regulators, the OCC, had for two years been communicating concerns to Flagstar about its methodology for estimating its ALLL and whether that method was consistent with U.S. Generally Accepted Accounting Principles ("GAAP"). Kosiek identified "[c]ontinued criticisms from regulator examination reports" to be a risk of material misstatement, regularly communicated with the OCC, and believed "that the views of regulatory agencies such as the OCC needed to be considered when evaluating any financial statement assertions under GAAP."

9. During the 2013 Audit, Kosiek understood from a "company-prepared summary" that Flagstar was changing its ALLL methodology in the fourth quarter, in part to address the OCC's concerns, by adding improved risk factors to its residential segmentation process and by applying a qualitative adjustment to account for the loss history of certain non-performing loans.

10. By the end of the 2013 Audit, Kosiek became aware that Flagstar was reducing its reported ALLL from $305 million at year-end 2012 to $207 million, and was decreasing the corresponding expense against earnings from $276 million to $70 million. Additionally, by the time Kosiek signed the audit opinion, members of Kosiek's engagement team had received and documented in the audit work papers evidence that Flagstar, based on its quantitative and qualitative assessment set forth in a company-prepared summary, was excluding the loss history of certain non-performing loans from its ALLL model, without applying a planned off-setting qualitative adjustment. Kosiek concurred with this conclusion to exclude the loss history of the non-performing loans from its ALLL model, based on his review of the audit documentation, without noticing that the documentation showed that Flagstar did not apply the planned qualitative adjustment.

11. Second, with respect to Flagstar's internal controls, Kosiek failed to obtain sufficient audit evidence that Flagstar designed its ALLL controls to address the valuation assertion, which Kosiek believed was the most significant financial statement assertion for the ALLL account, and he obtained evidence that the ALLL controls that did exist were not operating effectively. Nevertheless, he concluded that Flagstar's internal controls were designed and operating effectively and relied on those controls in testing the ALLL reported in the financial statements.

12. Third, Kosiek did not sufficiently evaluate the methodology Flagstar used to arrive at the ALLL. In particular, Kosiek (i) failed to obtain sufficient appropriate audit evidence concerning the completeness and accuracy of information produced by Flagstar management, (ii) failed to obtain sufficient appropriate audit evidence

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6  See id. at 99.
concerning certain aspects of Flagstar's ALLL estimate and failed to evaluate for bias the selection and application of accounting policies related to the estimate, (iii) failed to adequately assess management's estimates as a whole for bias or fraud, and (iv) failed to adequately perform a qualitative assessment of Flagstar's accounting practices.

13. Later, as Kosiek approached the completion of his audit work, he failed to respond to evidence that undermined his understanding that Flagstar had re-introduced the loss history of the non-performing loans back into its ALLL model in the fourth quarter of 2013 through a qualitative adjustment—an understanding on which he based his evaluation of Flagstar's ALLL estimate. Just two weeks before Flagstar filed its Form 10-K, Kosiek learned that Flagstar's reported ALLL was not going to change between the third quarter of 2013 and year-end 2013. Kosiek, however, as part of the overall review, failed to evaluate sufficiently whether this information was unexpected in light of his belief that Flagstar had re-introduced the loss history of the non-performing loans back into its ALLL model in the fourth quarter through a qualitative adjustment. Five days later, Kosiek became aware of evidence that Flagstar's year-end ALLL may have been understated by at least $30 million. Nevertheless, Kosiek authorized the Firm's issuance of an audit report containing an unqualified opinion on Flagstar's ICFR and financial statements.

14. In the first quarter of 2014, Flagstar made an adjustment to its ALLL, increasing it from $207 million to $307 million and recording an increased loss expense against earnings.

15. Finally, Kosiek failed to make certain required disclosures to Flagstar's Audit Committee concerning Baker Tilly's audit of Flagstar's ALLL.

16. As a result of this conduct, Kosiek failed to act with due professional care, failed to obtain sufficient appropriate audit evidence, and failed to perform certain required audit procedures during the 2013 Audit of Flagstar's financial statements and ICFR.

D. Kosiek Violated PCAOB Rules and Standards in Connection with the Audit of Flagstar's FY 2013 Financial Statements and ICFR.

Applicable PCAOB Rules and Auditing Standards

17. In connection with the preparation or issuance of an audit report, PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards. An auditor may

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7 See PCAOB Rule 3100, Compliance with Auditing and Related Professional Practice Standards; PCAOB Rule 3200T, Interim Auditing Standards. All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the 2013 Audit. As of December 31, 2016, the PCAOB
express an 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, and after the auditor has evaluated whether the financial
statements are "presented fairly, in all material respects, in conformity with" applicable
accounting principles. Among other things, PCAOB standards require that an auditor (i)
exercise due professional care, including professional skepticism, in the performance of
the audit, and (ii) plan and perform audit procedures to obtain sufficient appropriate
audit evidence to provide a reasonable basis for the audit opinion. Audit evidence is all
the information, whether obtained from audit procedures or other sources, that is used
by the auditor in arriving at the conclusions on which the auditor’s opinion is based. If
the auditor is unable to obtain sufficient appropriate audit evidence to have a
reasonable basis to conclude about whether the financial statements as a whole are
free of material misstatement, the auditor should express a qualified opinion or a
disclaimer of opinion.

18. PCAOB auditing standards require that, when using information produced
by the company as audit evidence, the auditor should evaluate whether the information
is sufficient and appropriate for purposes of the audit by performing procedures both
(i) "[t]est[ing] the accuracy and completeness of the information, or test[ing] the controls
over the accuracy and completeness of that information," and (ii) "[e]valuat[ing] whether
the information is sufficiently precise and detailed for purposes of the audit." If
the auditor is unable to obtain sufficient appropriate audit evidence to have a
reasonable basis to conclude about whether the financial statements as a whole are
free of material misstatement, the auditor should express a qualified opinion or a
disclaimer of opinion.

19. PCAOB auditing standards also require auditors to perform certain
procedures relating to management estimates. Those standards state that auditors
should perform procedures to "obtain sufficient appropriate evidential matter to provide
reasonable assurance" that those estimates are reasonable in the context of the

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 Rel. No. 2015-002 (Mar. 31,
2015); see also PCAOB Auditing Standards Reorganized and Pre-Reorganized

8  See AU § 508.07, Reports on Audited Financial Statements.
9  Auditing Standard No. 14, Evaluating Audit Results ("AS No. 14"), ¶ 30.
10 See Auditing Standard No. 13, The Auditor’s Responses to the Risks of
Material Misstatement ("AS No. 13"), ¶ 7; AU § 150, Generally Accepted Auditing
Standards; AU §§ 230.01, 07, Due Professional Care in the Performance of Work.
11 See Auditing Standard No. 15, Audit Evidence ("AS No. 15"), ¶ 4.
12 See id. ¶ 2.
13 AS No. 15 ¶ 10.
financial statements taken as a whole and are presented in conformity with GAAP, and should evaluate whether the company's selection and application of accounting principles related to the estimates indicate management bias. Additionally, in connection with both evaluating management's judgments as a whole and evaluating whether the financial statements might be materially misstated due to fraud, the auditor should perform procedures to evaluate potential bias in estimates, including a retrospective review of significant accounting estimates used in the prior year.

20. When evaluating whether the financial statements as a whole are free of material misstatement, the auditor should: (i) evaluate potential management bias in accounting estimates as part of the larger evaluation of "the qualitative aspects of the company's accounting practices"; and (ii) perform analytical procedures to evaluate significant accounts and disclosures, including to evaluate any unusual or unexpected amounts or relationships in the financial statements.

21. PCAOB standards state that, if an auditor obtains "sufficient and appropriate audit evidence...to assess control risk at less than the maximum," the auditor may "modify the nature, timing, and extent of planned substantive procedures" in reliance on the company's internal controls. An auditor should perform control testing procedures to obtain that evidence. If the auditor does not obtain sufficient appropriate audit evidence to support a control risk assessment below the maximum level, he or she should assess control risk at the maximum level for the relevant assertions.

22. In connection with an integrated audit of financial statements and ICFR, the auditor must "plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance about whether material weaknesses exist" in the issuer's ICFR as of the date specified in management's assessment. In doing so,

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14 AU §§ 342.04, .07.
15 See AS No. 13 ¶ 5(d).
16 See AS No. 14 ¶ 27; AU § 316.64, Consideration of Fraud in a Financial Statement Audit.
17 AS No. 14 ¶¶ 24, 25(d).
18 See id. ¶¶ 5-6.
19 AS No. 13 ¶ 16 & n.12.
20 See id. ¶ 9(c)(1).
21 See id. ¶ 33.
22 Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements ("AS No. 5"), ¶ 3. A
the auditor should identify significant accounts and disclosures and their relevant assertions, should test the design effectiveness of controls by determining whether they satisfy the control objectives and can effectively prevent or detect errors or fraud that could result in a material misstatement, and should test those controls that are important to the auditor’s conclusion about whether the company’s controls sufficiently address the assessed risk of misstatement for each relevant assertion. The evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control: as the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases.

23. If an engagement partner supervises the performance of audit procedures by members of the engagement team, the partner is required under PCAOB standards to review the work of the team members to evaluate whether the objectives of the procedures were achieved and whether the results of the work support the conclusions reached. In determining the extent of supervision necessary in such circumstances, the partner should also take into account the assessed risks relating to accounts that present a risk of material misstatement.

material weakness may exist even when the financial statements are not materially misstated. See id.

23 See id. ¶ 28.
24 See id. ¶ 42.
25 See id. ¶ 39.
26 See id. ¶ 46.
27 See Auditing Standard No. 10, Supervision of the Audit Engagement ("AS No. 10"), ¶ 5(c).
28 See AS No. 13 ¶ 5(b).
24. When Flagstar disclosed its financial statements for each quarter, one asset on its balance sheet was its portfolio of loans classified as held for investment ("HFI"). Certain of those loans were marked to fair value, but most were recorded at the value of their unpaid balances, with an accompanying ALLL that represented Flagstar's estimate of the probable future losses associated with those loans. Flagstar also disclosed on its income statement the provision for loan losses ("loss expense") by which it was required to reduce pre-tax earnings in order to maintain an adequate ALLL.29

25. GAAP required that Flagstar's methodology for estimating its ALLL ("ALLL methodology") include two separate, but related, processes. For impaired loans (i.e., loans for which Flagstar believed it was probable that it would not collect all amounts due based on an individualized assessment), Flagstar was required to establish a separate allowance for each loan.30 For unimpaired loans, Flagstar was required to estimate its potential losses for the portfolio as a whole.31 Flagstar calculated these potential losses by dividing the unimpaired portfolio into segments and then estimating the probable losses for each segment based on its historical loss experience.

26. To arrive at the ALLL that it disclosed in its financial statements, Flagstar multiplied the value of each segment of unimpaired loans by the estimated loss percentage for that segment, then aggregated those with the separate allowance for each of its impaired loans.

27. The reasonableness of Flagstar's ALLL, therefore, depended in large part on a number of complex and often subjective decisions, which were subject to the potential for management bias, such as: (i) properly identifying and valuing impaired loans; (ii) appropriately segmenting its unimpaired loans into groups that were sufficiently homogeneous that it was appropriate to apply a single loss rate to the entire group; and (iii) applying an appropriate loss rate, derived from Flagstar's relevant historical experience, to each unimpaired segment.

29 See ASC 450-20 (formerly Statement of Financial Accounting Standard ["FAS"] 5, Accounting for Contingencies); ASC 310-10-35 (formerly FAS 114, Accounting by Creditors for Impairment of a Loan). This Order's description of audit failures relating to Flagstar's application of GAAP necessarily reflects the Board's judgment concerning the proper application of GAAP; any such description, however, should not be understood as an indication that the Board or the Commission has considered or made any determination concerning Flagstar's compliance with GAAP.

30 See ASC 310-10-35.

31 See ASC 450-20; see also ASC 310-10-35-33.
28. During the summer of 2013, Flagstar sold two bundles of nonperforming and restructured residential loans ("Spartan Loans"). It then removed the data regarding the Spartan Loans' historical losses from its ALLL model.

Background: Kosiek’s Awareness of Issues Raised by the OCC Prior to 2013

29. Flagstar’s methodology for calculating its ALLL was reviewed by the OCC, one of its federal banking regulators. As part of Baker Tilly’s reviews and audits of Flagstar’s financial statements, Kosiek regularly communicated directly with the OCC to learn the results of the OCC’s reviews. Kosiek gave weight to the OCC’s views in making his own determination concerning Flagstar’s compliance with GAAP.

30. On October 23, 2012, the OCC and Flagstar agreed to a Consent Order that, among other things, required Flagstar to "adopt written policies and procedures for maintaining adequate [ALLL] in accordance with [GAAP]," including "procedures for validating the ALLL methodology." Specifically, the OCC required Flagstar to adopt "written policies and procedures for maintaining adequate [ALLL] in accordance with [GAAP]." The OCC further required that the policies and procedures at a minimum include procedures for determining loan impairment consistent with GAAP, procedures for segmenting the loan portfolio consistent with GAAP, procedures for validating the ALLL methodology, and a process to ensure that Flagstar’s Board of Directors reviewed the ALLL.

31. In its Form 10-K for the year ended December 31, 2012, Flagstar reported an ALLL of $305 million, which required it to take a loss expense against earnings of $276 million, an increase of $100 million from the prior year. For the 2012 fiscal year, the company reported net income of $68 million.

32. As the engagement partner on the Flagstar audit since 2010, Kosiek was familiar with the OCC’s views concerning Flagstar’s ALLL, the Consent Order generally, and how Flagstar reported on its ALLL at year end.

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32 "Spartan" referred to an internal project and not the name of a bank.

33 When non-performing loans are removed from the loss history of an ALLL model, the model’s projection for the performance of similar remaining loans that are performing improves because the model considers it less likely that those remaining loans will also become non-performing.


35 The Consent Order remained in place during the 2013 Audit discussed herein. On December 20, 2016, Flagstar announced that the OCC had terminated the Consent Order.
2013 Audit

33. Kosiek acted as the engagement partner for the integrated audit of Flagstar's FY 2013 ICFR and financial statements. Based on that audit, the Firm issued an unqualified audit report on March 4, 2014, stating that Flagstar's FY 2013 financial statements were fairly presented in accordance with GAAP and that Flagstar maintained effective ICFR as of December 31, 2013. That report was included in Flagstar's Form 10-K filed with the U.S. Securities and Exchange Commission ("Commission") on March 5, 2014.

34. In its Form 10-K for FY 2013, Flagstar reported total assets of $9.4 billion, of which approximately $4 billion were HFI loans. These loans consisted primarily of consumer loans, including approximately $2.7 billion of residential mortgages and home equity lines of credit, but also included commercial real estate and other loans. Of the $4 billion HFI portfolio, $238 million was marked to fair value, while approximately $3.8 billion was recorded as unpaid balances with an accompanying ALLL of $207 million.

Kosiek's Knowledge of Facts Regarding Flagstar's ALLL Methodology

35. At the time of the 2013 Audit, Kosiek had been the engagement partner for Baker Tilly's Flagstar audit since 2010. He was, therefore, on notice, as a result of multiple events, that Flagstar management's process for estimating and reporting its ALLL might be affected by bias. Kosiek knew before and during the 2013 Audit that the OCC had concerns regarding Flagstar's ALLL methodology, and Kosiek identified "[c]ontinued criticisms from regulator examination reports" to be a risk of material misstatement. In response, he planned to monitor Flagstar's progress relative to the Consent Order to understand Flagstar's actions to address the items therein. As part of that monitoring, Kosiek understood that Flagstar had changed its ALLL methodology in part to address the OCC's concerns. Kosiek failed to obtain sufficient evidence to support his understanding, even when presented with indications that Flagstar, based on its assessment of portfolio performance and characteristics, including the exclusion of the actual losses incurred on the sale of the Spartan Loans from its historical loss experience, had not changed its fourth quarter ALLL methodology. He therefore failed during the 2013 Audit to sufficiently evaluate whether Flagstar's approach to its fourth quarter ALLL methodology indicated management bias in the application of the ALLL accounting policy.

36. Kosiek, who had been the engagement partner for Baker Tilly's Flagstar audit since 2010, had knowledge of the OCC's continued concerns about Flagstar's ALLL methodology and was aware that the OCC had not yet terminated the Consent Order. He also knew that Flagstar was planning to reduce its reported ALLL from $305

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36 See Flagstar 10-K at 127.
37 See id. at 142, 168.
million to $207 million, resulting in the company recording a loss expense of only $70 million for all of FY 2013. Kosiek failed, however, both to apply appropriate professional skepticism to his audit procedures concerning Flagstar's ALLL methodology and to evaluate whether these events were indications of bias in the application of accounting policies.38

37. Regarding segmentation for its residential loans, Flagstar used two factors—loan to value39 and credit score of the loan holder—to segment the portfolio. Flagstar told Kosiek that: (i) it was adjusting the two risk factors—loan to value and credit score—that it used to segment its residential portfolio, and (ii) it had concluded based on internal analysis that, in light of that adjustment, additional segmentation factors were unnecessary to address the OCC's concerns. Kosiek failed to perform sufficient procedures to determine whether Flagstar's adjustment and internal analysis had been appropriately performed in the fourth quarter of 2013 and if the resulting ALLL was an appropriate estimate. Kosiek thus failed to obtain sufficient appropriate audit evidence to allow him to evaluate whether the data underlying Flagstar's adjusted segmentation was complete and accurate or whether the adjustment obviated the need for additional segmentation factors.

38. Concerning the Spartan Loans, Kosiek came to understand from a "company-prepared summary" that, in part to address the OCC's concerns, Flagstar was adding the Spartan Loans' performance history back into its FY 2013 analysis through a qualitative adjustment during the fourth quarter. Other than reviewing this client-prepared document, however, Kosiek failed to obtain any audit evidence to support his understanding. As discussed below, both his understanding and this failure persisted even after the engagement team received and documented a later representation from Flagstar that contradicted Kosiek's earlier understanding.

Kosiek Violated PCAOB Standards in Auditing Flagstar's ALLL Controls and Methodology During the 2013 Audit.

39. Kosiek failed to obtain sufficient evidence during the 2013 Audit that Flagstar's ALLL controls were designed and operating effectively, and also failed to properly evaluate Flagstar's ALLL methodology in the context of its reported financial statements.40

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38 See AS No. 13 ¶ 5(d).

39 "Loan to value" is a comparison between the unpaid balance of a loan and the value of its underlying collateral, such as a house in the case of a residential mortgage. Generally, loans that represent a large share of (or exceed) the value of the collateral are considered to pose a higher risk of default.

40 This Order's description of audit failures relating to Flagstar's ICFR necessarily reflects the Board's judgment concerning the proper application of Internal
40. At the time of the 2013 Audit, Kosiek came to understand from a "company-prepared summary" that, for its year-end FY 2013 financial statements, Flagstar would make another attempt to respond to the OCC's concerns by taking a number of steps to improve its ALLL methodology. These steps included adding the loss history of the Spartan Loans back into the ALLL model through a qualitative adjustment. Kosiek carried out the 2013 Audit in reliance on that understanding, despite obtaining no other evidence to support it, and, as discussed below, failed to respond to evidence that Flagstar had not, in fact, added the Spartan Loans back into its model.

**Kosiek Failed to Obtain Sufficient Appropriate Audit Evidence Concerning Flagstar's ALLL Controls**

44. Second, Kosiek knew that his team's testing of the operating effectiveness of Flagstar's ALLL controls consisted merely of reviewing and commenting on Flagstar's

\[\text{Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission; any such description, however, should not be understood as an indication that the Board or the Commission has considered or made any determination concerning whether Flagstar's ICFR contained a material weakness.}\]

41. See AS No. 5.

42. See AS No. 13 ¶ 16 & n.12.

43. See AS No. 5 ¶¶ 11, 46.
documentation of its internal control testing process, documentation that identified operating deficiencies in the ALLL controls related to management's review process, documentation process, and change control process. Kosiek failed to take any additional steps to obtain sufficient appropriate evidence to conclude that Flagstar's ALLL controls were operating effectively.

45. As a result, Kosiek failed to comply with PCAOB standards when he failed to obtain sufficient appropriate audit evidence to support his unqualified ICFR report, and when he assessed control risk at below maximum without having obtained sufficient appropriate evidence to support an assessment below the maximum level.44

Kosiek Failed to Obtain Sufficient Appropriate Evidence Concerning Flagstar's ALLL Methodology for the Financial Statement Audit.

46. Despite failing to obtain sufficient appropriate audit evidence to support a control risk assessment for the ALLL below the maximum level, Kosiek, in fact, modified the nature, timing, and extent of his substantive procedures as if he had. This reliance on Flagstar's controls over its ALLL violated PCAOB standards.45 Additionally, he failed in other ways to obtain sufficient appropriate evidence that the ALLL, including the valuation assertion, was reasonable when auditing Flagstar's financial statements.

47. As stated above, because the ALLL was an estimate, Kosiek was required by PCAOB standards to perform procedures to evaluate the ALLL both individually and in the larger context of management's financial reporting, including by performing procedures to address the possibility of management bias. Kosiek failed to perform these required procedures with due professional care, including professional skepticism.46

48. First, Flagstar's ALLL for its unimpaired loans was calculated by a model that received inputs from multiple internal reports, some of which provided the information on which the model segmented the loan portfolio into what were represented to be homogeneous groups, and some of which fed into the loss rate that the model calculated for each segment based on historical experience. Kosiek planned that the Baker Tilly engagement team would evaluate the reasonableness of the ALLL by reviewing and testing management's process for using those reports in the ALLL model. Consistent with that approach, the team received copies of the internal reports from Flagstar, but PCAOB standards required that in order to use those reports as evidence, Kosiek should have evaluated whether the information was sufficient and

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44 See AS No. 5 ¶ 3; AS No. 13 ¶ 33.
45 See AS No. 13 ¶ 33.
46 See AU § 230.02.
appropriate for purposes of the audit by performing procedures to test the accuracy and completeness of the information.\(^\text{47}\)

49. Kosiek failed to perform procedures to obtain sufficient evidence concerning the accuracy and completeness of those management reports. In fact, Kosiek failed to obtain any evidence of completeness as to any of the reports, and as to most of them he failed to obtain any evidence of accuracy. For example:

- The reports from management concerning consumer credit scores and loan-to-value information formed the basis for the segmentation of the residential loans into what were represented to be homogeneous groups within the ALLL model. Kosiek failed to perform any procedures, such as reviewing loan files, to test the accuracy and completeness of the credit score and loan-to-value information.

- Other reports from management contained the historical loss experience that was used to calculate the loss rate for each segment of residential loans. Kosiek failed, however, to perform any procedures to test the accuracy and completeness of the historical loss information.

- For Flagstar's commercial loans, Kosiek planned that the engagement team would perform a review of specific loan files to obtain evidence concerning Flagstar's commercial risk rating process. During the audit, he decided to rely instead on processes conducted by Flagstar and its agents. Kosiek failed, however, to perform procedures to test the accuracy and completeness of the information generated by those processes. For the first half of the year, Flagstar's loan file reviews were performed by an outside consultant; for the second half of the year, they were performed by internal reviewers. Despite the fact that the outside consultant detected weaknesses in Flagstar's risk rating systems caused by "[i]ncomplete or inaccurate credit analyses," Kosiek simply assumed, without evidence, that Flagstar's commercial risk ratings for the entire year were accurate and complete.

50. Second, in evaluating the ALLL estimate itself, Kosiek failed to obtain sufficient evidence that the estimate was reasonable, and failed to adequately evaluate whether Flagstar's application of its ALLL methodology indicated management bias. Other than the management-provided reports mentioned above, the only additional evidence Kosiek gathered concerning Flagstar's ALLL methodology was (i) management documents describing the methodology, (ii) evidence concerning the basis for certain qualitative adjustments that Flagstar made to its projected loss rates, and (iii) evidence from a recalculation procedure that the ALLL model calculations were

\(^{47}\) See AS No. 15 ¶ 10.
mathematically accurate. This evidence did not, as a whole, provide him with sufficient appropriate audit evidence to determine whether the ALLL was properly valued, and Kosiek did not adequately evaluate whether management was biased in its application of the ALLL methodology.48

51. For example, one important aspect of Flagstar's ALLL estimation process was its identification of impaired loans to be segregated for individual assessment. Kosiek failed to perform, and failed to ensure that his team performed, any procedures, such as reviewing loan files, to obtain evidence concerning Flagstar's process for identifying impaired loans. In fact, Kosiek knew that the Baker Tilly engagement team did not review any loan files, consumer or commercial, during the 2013 Audit. These failures occurred despite Kosiek's knowledge that the OCC had concerns about Flagstar's ALLL methodology, and that the OCC had not yet terminated the Consent Order, which, among other things, required Flagstar to include policies and procedures for determining loan impairment consistent with GAAP.

52. Third, Kosiek failed to properly evaluate management's estimates as a whole, both by failing to evaluate the estimates in total for bias and by failing to conduct a retrospective review of those estimates. During the planning phase of the 2013 Audit, Kosiek planned to conduct a retrospective review of Flagstar's accounting estimates, including its ALLL, and in fact Kosiek believed at the time that such a review was performed. He took no steps, however, to review any work papers to verify that the procedure had been performed or what the results were. He therefore failed both to conduct the retrospective review and to properly supervise his team in the performance of its procedures.49 Additionally, Kosiek failed to evaluate whether the cumulative effect of differences between estimates included in the financial statements and estimates best supported by the audit evidence indicated potential management bias in the estimates.50 These failures occurred despite the fact that Kosiek identified the ALLL as a significant risk and identified Flagstar's valuation of its ALLL, a management estimate, as one of the highest risk areas of the audit, which should have affected the extent of the supervision necessary on the engagement team's work concerning the ALLL.51

53. Fourth, Kosiek failed at the end of the 2013 Audit to adequately evaluate the qualitative aspects of Flagstar's accounting, including potential management bias in accounting estimates, and to perform adequate analytical procedures to evaluate unusual or unexpected amounts or relationships in Flagstar's financial statements. These failures occurred in part because Kosiek failed to act upon updated management

48 See AU §§ 342.04, .07; AS No. 13 ¶ 5(d).
49 See AU § 316.64; AS No. 10 ¶ 5(c).
50 See AS No. 14 ¶ 27.
51 See AS No. 13 ¶ 5(b).
representations that he received in February 2014 concerning Flagstar's treatment of the Spartan Loans.

54. On February 19, 2014, two weeks before Baker Tilly's audit report was issued, Kosiek read and assessed the principal ALLL work paper. The work paper documented Flagstar's decision to set the 2013 year-end ALLL at $207 million—the exact same amount as Flagstar's September 30, 2013 ALLL.

55. The work paper also contained a note from Kosiek's engagement team explaining, in part, why the ALLL had not changed from the third quarter to the fourth quarter—namely, that the team had received a new management representation in January 2014 that, contrary to Kosiek's understanding, Flagstar was not going to re-introduce the Spartan Loans' loss history back into its ALLL model for FY 2013 through an adjustment to its qualitative factors due to a lack of internal follow-up. Kosiek failed to respond to this information.

56. Five days later, on February 24, 2014, the day before Kosiek presented the results of the 2013 Audit to the Flagstar Audit Committee, Kosiek became aware of evidence that Flagstar's year-end ALLL may have been understated by at least $30 million. This $30 million amount represented over 40 percent of the loss expense that Flagstar planned to report for the year, as well as over 25 percent of its net interest income after the provision for loan losses. As part of the overall review, Kosiek failed to evaluate whether no change in the ALLL at year end was unexpected under the circumstances (despite his belief that Flagstar had introduced the Spartan Loans back into its ALLL model in the fourth quarter), and, thereby, failed to evaluate whether the evidence gathered in response to the unexpected ALLL amount was sufficient.52

* * *

57. On March 4, 2014, Kosiek authorized Baker Tilly's issuance of an unqualified report on Flagstar's financial statements and ICFR. This authorization was based on his conclusion that Flagstar's financial statements, containing an ALLL of $207 million and a loss expense of $70 million, were fairly stated. In coming to this conclusion, Kosiek failed to adequately evaluate (i) whether the evidence he had gathered in response to unusual or unexpected events was sufficient, and (ii) whether he had obtained sufficient appropriate audit evidence to support his opinion on the financial statements.53

52 See AS No. 14 ¶ 6.
53 See id. ¶¶ 6(a), 33.
58. As a result of the above conduct, Kosiek failed to perform the 2013 Audit with due professional care, including professional skepticism.54

59. On May 9, 2014, Flagstar filed its Form 10-Q for the first quarter of 2014 with the Commission. In its first-quarter 2014 financial statements, Flagstar reported an ALLL of $307 million, a $100 million increase over year-end 2013, only three months earlier. The higher estimate was due, in part, to Flagstar's adding the loss history of the Spartan Loans back into its model. As a result of its higher ALLL, Flagstar was required for the first quarter to take a provision against earnings of over $112 million.

E. Kosiek Failed to Make All Required Communications to the Flagstar Audit Committee.

Applicable PCAOB Auditing Standards

60. PCAOB Auditing Standard No. 16, Communications with Audit Committees ("AS No. 16"), requires that the auditor make certain communications to the client's audit committee at the conclusion of an audit, including: (a) changes in management's significant accounting policies and practices;55 (b) any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements;56 and (c) any other "matters arising from the audit that are significant to the oversight of the company's financial reporting process," including "complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters."57

Kosiek Violated PCAOB Auditing Standards Concerning Audit Committee Communications.

61. As stated above, Kosiek was aware during the 2013 Audit that Flagstar's year-end ALLL may have been understated by at least $30 million. Under the circumstances, Kosiek was required to inform the Flagstar Audit Committee about such evidence. Kosiek was also required to communicate to the Audit Committee more generally the effect of the Spartan Loans sales on Flagstar's accounting estimates. Kosiek failed, however, to communicate any of these matters to the Audit Committee, either at the February 25, 2014 meeting or at any other time. Kosiek therefore failed to comply with AS No. 16.

54 See AU §§ 230.02, .07.
55 See AS No. 16 ¶ 12(a)(1).
56 See id. ¶ 12(c).
57 Id. ¶ 24.
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), Timothy M. Kosiek is censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Timothy M. Kosiek 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);\(^{58}\)

C. After two (2) years from the date of this Order, Timothy M. Kosiek may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm; and

D. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $25,000 is imposed upon Timothy M. Kosiek. 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. Kosiek shall pay this civil money penalty within ten (10) days of the issuance of this Order by: (1) wire transfer in accordance with instructions furnished by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter, which identifies Kosiek 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: Phoebe W. Brown, Secretary,

\(^{58}\) As a consequence of the bar imposed in this Order, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Kosiek. Section 105(c)(7)(B) provides: "It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any issuer, broker, or dealer in an accountancy or a financial management capacity, and for any issuer, broker, or dealer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission."
ORDER


ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

April 26, 2019