



**ORDER**

- (4) limiting Babb's activities in connection with any "audit," as that term is defined in Section 110(1) of the Act for a period of two years, requiring that Babb complete ten additional hours of CPE, and imposing a \$10,000 civil money penalty on Babb.

The Board is imposing these sanctions based on its findings that: (1) Powell and Babb violated PCAOB rules and standards<sup>2</sup> in connection with the audits of the 2012-2014 financial statements of United Development Funding III, L.P., and the review of that issuer's Q3 2015 interim financial statements; (2) Lawlis violated PCAOB rules and standards in connection with the audits of the 2013-2014 financial statements of United Development Funding IV and the review of that issuer's Q3 2015 interim financial statements; and (3) WP violated PCAOB rules and standards by failing to design, implement, and maintain appropriate quality control policies and procedures.

**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 Respondents.

**II.**

In anticipation of the institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondents have submitted Offers of Settlement ("Offers") 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 Respondents and the subject matter of these proceedings, which is admitted,

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<sup>2</sup> All references to PCAOB rules and standards in this Order are to the versions of those rules and standards, and to their organization and numbering, in effect at the time of audits discussed herein. 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).

**ORDER**

Respondents consent to the entry of this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions ("Order"), as set forth below.<sup>3</sup>

**III.**

On the basis of Respondents' Offers, the Board finds that:<sup>4</sup>

**A. Respondents**

1. **Whitley Penn LLP** is a limited liability partnership organized under the laws of the State of Texas and headquartered in Fort Worth, Texas. The Firm is licensed by the State Boards of Accountancy in Texas (License No. P05377), California (License No. OFR659), New Jersey (License No. 20CZ00034600), Oklahoma (License No. 13919), and Minnesota (License No. F2269). The Firm is, and at all relevant times was, registered with the Board pursuant to Section 102 of the Act and PCAOB rules.

2. **Susan Lunn Powell, CPA**, is a certified public accountant licensed by the Texas State Board of Accountancy (License No. 078380). At all relevant times, Powell 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).

3. **Jeffrey Shannon Lawlis, CPA**, is a certified public accountant licensed by the Texas State Board of Accountancy (License No. 058485). At all relevant times, Lawlis 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).

4. **John Griffin Babb, CPA**, is a certified public accountant licensed by the Texas State Board of Accountancy (License No. 081948). Babb is 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).

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<sup>3</sup> The findings herein are made pursuant to the Offers and are not binding on any other person or entity in this or any other proceeding.

<sup>4</sup> The Board finds that Respondents' 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.

**ORDER****B. Issuers**

5. **United Development Funding III, L.P. ("UDF III")**, was an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). UDF III's public filings disclosed that it originated, acquired, serviced, and managed mortgage loans secured by real property or equity interests that held real property already subject to other mortgages.

6. **United Development Funding IV ("UDF IV")** was, at all relevant times, a Maryland real estate investment trust, and an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). UDF IV's public filings disclosed that it originated, purchased, participated in, and held for investment secured loans to persons and entities relating to real estate development.

7. UDF III and UDF IV were affiliates of one another and were under common management, along with several other affiliates (collectively, the "UDF Entities").

**C. Summary**

8. WP was the UDF Entities' external auditor, including for the year ended December 31, 2012 and continuing through the third quarter of 2015. Powell was the engagement partner for the audits and reviews of UDF III's 2012 through Q3 2015 financial statements. Babb was the engagement quality review ("EQR") partner for those same UDF III audits and reviews. Lawlis was the engagement partner for the audits and reviews of UDF IV's 2013 through Q3 2015 financial statements.

9. This matter concerns, among other things, (a) Powell's, Lawlis's, and Babb's failures to exercise due professional care, including professional skepticism, in connection with procedures they performed concerning loans made by UDF III and UDF IV to a key borrower, which accounted for a significant portion of each issuer's assets; (b) Powell's and Lawlis's failures to appropriately respond to evidence of possible undisclosed related party transactions between UDF III and UDF IV during the 2013 and 2014 audits; and (c) Whitley Penn's failure to maintain an adequate system of quality control ("QC system") both during and after those audit failures.

10. Specifically, Powell repeatedly failed to gather sufficient appropriate evidence to determine whether a significant loan was properly valued, and failed to adequately consider evidence indicating UDF III needed to record a substantial reserve for that loan. By Q3 2015, that loan accounted for \$104 million (26%) of UDF III's assets. Evidence gathered by Powell indicated that it could be impaired by as much as \$73 million at Q3 2015, which was approximately three times UDF III's total allowance for loan losses. Powell also failed to adequately respond to (a) evidence from confirmation procedures of a possible dispute between UDF III and the borrower for that loan and (b) the fact that UDF IV was repeatedly transferring cash to UDF III without either fund disclosing the transfers as related party transactions.

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11. Lawlis failed to adequately respond to evidence from confirmation procedures of a possible dispute between UDF IV and that same key borrower, whose loans accounted for approximately 10% of UDF IV's assets. Lawlis also failed to adequately respond to the transfers from UDF IV to UDF III that were not disclosed as related party transactions.

12. Babb, in connection with his EQRs for the UDF III audits, repeatedly failed to properly evaluate, with due professional care, the significant judgments that Powell made concerning the UDF III loan to the key borrower described above.

13. The above violations resulted, at least in part, from WP's insufficient QC system. During the period of the violations, WP's QC system failed to provide reasonable assurance that WP and its personnel performed audit work in accordance with professional standards or appropriately consulted with persons outside of the engagement team when necessary.

**D. Background****Notes Receivable and Key Customer**

14. The vast majority of UDF III's and UDF IV's assets were comprised of the notes receivable and accrued interest receivable balances from the loans they made. WP understood that the loans funded long-term development projects, with typical interest of 15% and above for UDF III, and 13% and above for UDF IV. WP also understood that UDF III and UDF IV typically set maturity dates on the loans for dates that were prior to the expected completion dates for the development projects. WP expected that UDF III and UDF IV would renew loans for ongoing projects if UDF III and UDF IV believed that the loan was adequately performing and collectable.

15. UDF III and UDF IV each reported their notes receivable both on a gross basis and net of an allowance for loan losses ("ALL"). The ALL was comprised of two components: (1) provisions for expected losses on loans individually evaluated for impairment ("specific reserves"), and (2) an accrual for losses on non-impaired loans.

16. UDF III and UDF IV recognized interest income from their loans on an accrual basis. Both funds disclosed that they suspend recognition of interest income on a loan when full recovery of principal and income was no longer probable. Accordingly, a loan that was impaired and not fully recoverable would also generally require suspension of interest revenue recognition.

17. One of the key borrowers for both UDF III and UDF IV was a group of related land development entities based in Austin, Texas (the "Austin Developer"). At all relevant times, UDF IV had several outstanding loans to the Austin Developer, which accounted for approximately 10% of UDF IV's assets and revenues. UDF III had just one outstanding loan to the Austin Developer, a line of credit (the "LOC"), which accounted for more than

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20% of UDF III's assets and revenues. The LOC bore interest at 15%, and was subordinate to both the UDF IV loans and other senior debt.

18. In December 2016, the UDF Entities entered into a settlement with the Austin Developer, which resulted in UDF III forgiving more than \$122 million of the Austin Developer's indebtedness to UDF III associated with the LOC.<sup>5</sup> Although UDF III disclosed that the settlement may have a material adverse impact on its financial statements, UDF III has not publicly filed any financial statements after the Q3 2015 financial statements that WP reviewed. WP completed its Q3 2015 review for UDF III in November 2015, and then declined to stand for reappointment as the UDF Entities' auditors three days later.

Settlement with the Commission

19. On July 3, 2018, UDF III and UDF IV, along with several members of their management, entered into a settlement with the U.S. Securities and Exchange Commission ("Commission").<sup>6</sup> The settlement stemmed from a Commission investigation that WP first learned about during the 2014 audits. The settlement concerned allegations by the Commission that UDF III had failed to recognize a specific impairment on the LOC and put the LOC on non-accrual status. It also concerned allegations that the UDF Entities did not disclose the true nature of the transactions involving cash transfers from UDF IV to UDF III for distribution to UDF III investors.

**E. Powell Failed to Obtain Sufficient Appropriate Evidence Concerning the ALL During the 2012-2014 UDF III Audits**

20. PCAOB rules require that registered public accounting firms and their associated persons comply with applicable auditing and related professional practice standards.<sup>7</sup> An auditor may 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

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<sup>5</sup> See Form 8-K filed by UDF III (Jan. 6, 2017). The impact of the settlement on UDF IV's financial statements has not been publicly reported.

<sup>6</sup> See *SEC Charges Real Estate Investment Funds and Executives for Misleading Investors*, SEC Lit. Rel. No. 24185 (Jul. 3, 2018); *Securities and Exchange Commission v. United Development Funding III, LP, et al.*, No. 3:18-cv-01735-L (N.D. Tex. filed July 3, 2018; final judgments entered Jul. 31, 2018).

<sup>7</sup> See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

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performed in accordance with PCAOB standards.<sup>8</sup> PCAOB standards require, among other things, that an auditor plan and perform the audit with due professional care<sup>9</sup> and to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion.<sup>10</sup>

21. The auditor must design and implement audit responses that address the risks of material misstatement that are identified and assessed during the audit.<sup>11</sup> In designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk.<sup>12</sup> To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based.<sup>13</sup>

22. Powell identified notes receivable as a significant account for each of the UDF III audits, and assessed that there were significant risks, including fraud risks, associated with that account. Powell designated the ALL as a "critical issue" and identified it as a significant estimate giving rise to high inherent risk for valuation of the net notes receivable balance. Powell also identified that management could perpetrate and conceal fraudulent financial reporting in connection with its notes receivable, including through understatement of the ALL.

23. Despite identifying those significant risks relating to UDF III's notes receivable, including the ALL, Powell failed to exercise due professional care, including professional skepticism when performing audit procedures over that account. In violation of PCAOB rules and standards, Powell failed to gather sufficient appropriate audit evidence about the value of the LOC, which was a significant loan. She also improperly relied on management estimates, data, and assumptions about that loan, without sufficiently evaluating their reasonableness.<sup>14</sup>

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<sup>8</sup> See AU § 508.07, *Reports on Audited Financial Statements*.

<sup>9</sup> See AU § 230.01, *Due Professional Care in the Performance of Work*.

<sup>10</sup> See AS 15, *Audit Evidence*, ¶ 4.

<sup>11</sup> See AS 13, *The Auditor's Responses to the Risks of Material Misstatement*, ¶ 3.

<sup>12</sup> See AS 13 ¶ 9.

<sup>13</sup> See AS 15 ¶ 6.

<sup>14</sup> See AU §§ 342.09-.10, *Auditing Accounting Estimates*.

**ORDER**2012 Evaluation of the LOC

24. At year-end 2012, the LOC accounted for approximately 22% (\$80 million) of UDF III's assets. UDF III's records indicated that the LOC collateral was also securing \$49 million in additional debt at year-end 2012, including \$26 million in senior debt. Powell knew that the LOC was past due as of year-end 2012 and UDF III management designated the LOC as impaired, but did not record any specific reserve for it in UDF III's ALL. During the audit, management asserted to Powell that it believed the loan was collectable. Management also provided Powell with documentation showing UDF III renewed the LOC in late March 2013.

25. In her initial analysis of the LOC for the 2012 audit, Powell noted that, if all of the land currently listed as collateral for the LOC was fully developed and sold, the lot sales would not generate sufficient proceeds to repay the LOC and other senior debt secured by the same collateral.

26. Nevertheless, Powell ultimately agreed with management that UDF III likely could collect the full amount of principal and interest, and that no specific reserve or suspension of revenue recognition was necessary. Powell based her conclusion on a revised projection that the Austin Developer's total future cash receipts from the development and sale of all lots would be approximately \$152 million, exceeding the outstanding total debt and accrued interest by approximately \$23 million. That calculation was based on management-provided data about the number of lots available for sale to repay the loan, the projected sale prices of those lots, and the amounts the Austin Developer would receive in development incentives.

27. Powell, however, failed to perform her analysis with due professional care and, as a result, failed to obtain sufficient appropriate audit evidence to support her conclusions about the LOC.<sup>15</sup> For example, in performing that analysis, Powell did not adequately:

- Test the accuracy and completeness of management-provided data that was critical to her calculation,<sup>16</sup> including the number of lots that remained for sale, despite receiving a schedule from management indicating that some of the lots identified as collateral might have been sold already;

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<sup>15</sup> See AS 15 ¶ 4.

<sup>16</sup> See AS 15 ¶ 10.

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- Evaluate the reasonableness of key factors and assumptions that were significant to the analysis, including the projected costs that would affect the collectability of the loan (e.g., future development costs being funded through senior debt);<sup>17</sup> and
- Discount the future cash receipts to present value in her analysis, despite knowing that the interest rate on the LOC was 15% and the developments would take several more years to complete.<sup>18</sup>

28. Powell also considered that management had informed her that the Austin Developer had "pledged" additional collateral to support the repayment of the LOC, which it claimed would increase the number of lots available for sale. However, Powell did not take adequate steps during the 2012 audit to analyze that pledge and determine whether it, in fact, added valuable collateral to the LOC. Powell also did not consider whether that pledged collateral was, itself, subject to senior liens that affected the collateral's value.

29. As a result of these deficiencies, Powell failed to obtain sufficient appropriate audit evidence to determine whether UDF III's reported 2012 notes receivable was properly valued and whether revenue recognition should have been suspended for the LOC.

#### 2013 Evaluation of the LOC

30. For the 2013 audit, Powell again failed to appropriately evaluate management's conclusions concerning the impairment and specific reserves of the LOC.

31. During the 2013 audit, Powell identified that available appraisals or other initial WP testing did not support the valuation of the LOC, which then accounted for approximately 23% (\$84 million) of UDF III's assets. The engagement team asked management for additional support for the value of the LOC and, in response, received a cash flow analysis reflecting management's conclusions concerning the collectability and value of the LOC. Management's analysis for the LOC calculated that there would be \$173 million of cash flows that could be used to satisfy that loan.

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<sup>17</sup> See AU § 342.09.

<sup>18</sup> Cf. ASC 310-10-35-25 ("If a creditor bases its measure of loan impairment on a present value amount, the creditor shall calculate that present value amount based on an estimate of the expected future cash flows of the impaired loan, discounted at the loan's effective interest rate.").

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32. Powell, however, failed to adequately evaluate whether the information contained within the cash flow projection was sufficient and appropriate for purposes of the audit, as required by PCAOB standards.<sup>19</sup> She failed to adequately test the accuracy and completeness of the information in the cash flow projections, or to test the controls over the accuracy and completeness of that information.<sup>20</sup> She also failed to adequately evaluate whether the information was sufficiently precise and detailed for purposes of the audit.<sup>21</sup>

33. Specifically, while Powell performed testing procedures over certain data in the management cash-flow analysis, such as lot pricing data, she failed to plan or perform procedures to evaluate or test certain other critical data and assumptions. For example, she failed to test the accuracy, completeness and reasonableness of:

- Data in the cash flow model about the number of lots that would be developed and were available for sale in the future, including whether the underlying projects existed;
- Data and assumptions in the cash flow model relating to the amount of future development costs that would be incurred as senior debt; and
- Data and assumptions in the cash flow model about the timing of the estimated cash advances and repayments, which were important to the analysis because of the LOC's 15% interest rate.

34. As a result of these deficiencies with the LOC testing, Powell failed to obtain sufficient appropriate audit evidence to determine whether UDF III's reported 2013 notes receivable was properly valued and whether revenue recognition should have been suspended for the LOC.

#### 2014 Evaluation of the LOC

35. For the 2014 audit, Powell again failed to appropriately evaluate management's conclusions concerning the impairment and specific reserves of the LOC. By that time, the LOC accounted for approximately 24% (\$94 million) of UDF III's assets.

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<sup>19</sup> See AS 15 ¶ 10.

<sup>20</sup> See id.

<sup>21</sup> See id.

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Management's 2014 analysis for the LOC calculated that there would be \$176 million of cash flows that could be used to satisfy the LOC.

36. By the time of the 2014 audit, Powell was aware that the Commission had commenced an investigation of the UDF Entities that included questions about UDF III's monitoring of the LOC, the valuation of the LOC's collateral, and management's decision to renew the LOC in 2013. This information should have caused her to exercise heightened professional skepticism when testing the value and impairment of the LOC, but she failed to do so.<sup>22</sup>

37. Powell also failed to adequately consider additional information which should have caused her to review the analyses with heightened professional skepticism. For example, during the 2014 audit, UDF III told Powell that the principal of the Austin Developer had informed the UDF Entities of his desire to retire, and was negotiating a settlement with the UDF Entities. Management indicated that the settlement negotiations were ongoing, and that management anticipated a settlement involving another developer taking over the projects reflected in the LOC cash flow analysis, which consisted of both existing projects and "future projects."

38. Powell also failed to adequately consider that:

- There had not been any cash payments of principal on the LOC during 2014, despite management's 2013 cash flow analysis projecting a substantial pay-down of the LOC in 2014;
- The cash flow analysis for the LOC included proceeds from "future projects," for which the WP engagement team had no evidence to support that they existed; and
- The ongoing settlement negotiations with the Austin Developer could indicate a dispute with the Austin Developer, and the Austin Developer did not respond to confirmation requests about its 2014 loan balance, despite responding to similar requests in prior audits.<sup>23</sup>

39. Powell again relied on management's cash flow analysis in testing the LOC for potential impairment, but she again failed to adequately test the accuracy and completeness of the information in the cash flow projections, despite all of the foregoing information. Powell reviewed a summary cash flow for the LOC, as well as a selection of five cash flow analyses for individual development projects that she understood were

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<sup>22</sup> See AU § 230.07.

<sup>23</sup> See Section III.F, infra.

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generating repayments reflected in the summary cash flow. Powell also discussed the cash flow analysis with management, and reviewed management's support for the lot pricing management used in the cash flow model. Based on those steps, and inquiry to management about the LOC's status, Powell concluded that the LOC was fully collectable.

40. However, Powell again failed to adequately evaluate whether the information contained within the cash flow projection was sufficient and appropriate for purposes of the audit.<sup>24</sup> While she performed testing procedures over certain data in the cash flow projection, she again failed to test the completeness and accuracy of other critical data and assumptions, including the number of lots that would repay the loans, the timing of estimated cash advances and repayments, or the projected amounts of future development costs.<sup>25</sup> Powell also failed to take adequate steps during the 2014 audit to understand the nature of the "future projects" management included in its cash flow projection, and their qualitative and quantitative impact on the cash flow analysis. As a result, Powell failed to obtain sufficient appropriate audit evidence to determine whether UDF III's reported 2014 notes receivable was properly valued and whether revenue recognition should have been suspended for the LOC.<sup>26</sup>

**F. Powell and Lawlis Failed to Properly Evaluate the Results of the Confirmation Procedures Concerning the Austin Developer during the 2014 UDF III and UDF IV Audits**

41. Both Powell and Lawlis violated PCAOB rules and standards in their respective UDF III and UDF IV 2014 audits by failing to follow-up on (a) loan confirmation requests to the Austin Developer and (b) information that management provided to explain the Austin Developer's failure to respond to a confirmation request.<sup>27</sup>

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<sup>24</sup> See AS 15 ¶ 10.

<sup>25</sup> See AS 15 ¶ 10; AU § 342.09.

<sup>26</sup> See AS 15 ¶¶ 4-6.

<sup>27</sup> See AU § 330.30, *The Confirmation Process* ("When using confirmation requests other than the negative form, the auditor should generally follow up with a second and sometimes a third request to those parties from whom replies have not been received."); AU § 330.33 ("If the combined evidence provided by the confirmations, alternative procedures, and other procedures is not sufficient, the auditor should request

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42. At year-end 2014, the Austin Developer's debt to UDF III was comprised entirely of the LOC. The Austin Developer's debt to UDF IV was comprised of multiple loans, accounting for approximately 10% of UDF IV's assets. Roughly half of the Austin Developer's debt to UDF IV was overdue at the time of the audit and designated as impaired by management.

43. Both engagement teams considered it appropriate to send confirmation requests to the Austin Developer. After receiving confirmation requests from the engagement teams, the Austin Developer did not respond, despite having responded to such requests in the past, including for the 2013 audits. Management for the UDF Entities then informed both Powell and Lawlis that the Austin Developer would not respond to confirmation requests due to its principal's intent to retire and ongoing negotiations between the UDF Entities and the Austin Developer. The UDF Entities also informed Powell and Lawlis that it would not further extend the due dates on any of the Austin Developer's loans.<sup>28</sup> Both Powell and Lawlis should have understood from those statements that there was a potential dispute between the Austin Developer and the UDF Entities, including UDF III and UDF IV. Nevertheless, they both failed to follow up with a second confirmation request.<sup>29</sup>

44. Having not received a response to their loan confirmation request, both engagement teams performed alternative procedures. The alternative procedures consisted of tying a selection of loan draws and paydowns to management provided documentation, including third party bank statements and draw requests signed by the borrowers, to roll forward the prior year's audited balance. However, the alternative procedures failed to provide sufficient evidence about the potential dispute concerning the Austin Developer and whether that dispute affected the loans' valuation. As a result, Powell and Lawlis failed to obtain sufficient audit evidence to determine whether the notes receivable were, among other things, properly valued for 2014.<sup>30</sup>

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additional confirmations or extend other tests, such as tests of details or analytical procedures.").

<sup>28</sup> Because management classified all overdue loans as impaired, Powell and Lawlis knew or should have known that such loans were likely to be classified as impaired by management as they came due, and therefore that they would need to be assessed for a potential specific reserve.

<sup>29</sup> See AU § 330.30.

<sup>30</sup> See AU § 330.33; AS 15 ¶¶ 4-6.

**ORDER****G. Powell and Lawlis Failed To Perform Sufficient Related Parties Procedures During the 2013 and 2014 UDF III and UDF IV Audits**

45. PCAOB standards recognize that, "[d]uring the course of the audit, the auditor may become aware of significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment."<sup>31</sup> The standards further provide that "[t]he auditor should gain an understanding of the business rationale for such transactions and whether that rationale (or the lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets."<sup>32</sup>

46. PCAOB standards also provide that, when examining related party transactions, "the auditor should be aware that the substance of a particular transaction could be significantly different from its form and that financial statements should recognize the substance of particular transactions rather than merely their legal form."<sup>33</sup> After identifying related party transactions, "the auditor should apply the procedures he considers necessary to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements."<sup>34</sup> For each material related party transaction (or aggregation of similar transactions), "the auditor should evaluate all the information available to him and satisfy himself that it is adequately disclosed in the financial statements."<sup>35</sup>

47. During their respective 2013 and 2014 UDF III and UDF IV audits, Powell and Lawlis designated related party transactions as a significant audit issue, but failed to

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<sup>31</sup> AU § 316.66, *Consideration of Fraud in a Financial Statement Audit*.

<sup>32</sup> Id.

<sup>33</sup> AU § 334.02, *Related Parties*; see also AU § 411.06, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* ("Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.").

<sup>34</sup> AU § 334.09.

<sup>35</sup> See AU § 334.11; see also Rule 4-08(k) of Regulation S-X, *Related party transactions which affect the financial statements*, codified as 17 C.F.R. 210.4-08(k).

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properly respond to evidence of unusual transfers from UDF IV to UDF III that were not disclosed as related party transactions.

Evaluation of Transfers During the 2013 Audits

48. During the 2013 audits, the WP engagement teams brought to the attention of both Powell and Lawlis certain unusual transfers from UDF IV to UDF III that management did not present or disclose as related party transactions. During the 2013 audits, the engagement teams learned that UDF IV transferred \$1.2 million to UDF III in January 2014 so that UDF III, which otherwise lacked sufficient cash, could make distributions to its investors that same day. The engagement teams also understood that the transfer had been recorded as loans by UDF IV to third-party borrowers and pay-downs of loans by those same borrowers to UDF III, even though: (a) UDF IV and UDF III's joint management had initiated the transfer, without the prior request or approval of any third-party borrower; (b) the transfer flowed directly from UDF IV to UDF III without notice to any third-party borrower; and (c) UDF IV and UDF III's joint management had unilaterally selected which third-party borrower and loans it would use to record the transfer, and did not finalize that selection until after the transfer had already been completed. The engagement teams communicated that understanding to Powell and Lawlis, sent them supporting documentation, and also advised them that there might be additional similar transactions.

49. Both Powell and Lawlis initially agreed that the transaction flagged by the engagement team was "strange" and questioned why the initial transfer was not recorded as a payable/receivable between UDF III and UDF IV, which they knew were related parties. Powell and Lawlis also agreed that they should determine how many similar transactions took place in 2013. Nevertheless, Powell and Lawlis failed to perform sufficient procedures to obtain satisfaction concerning the extent of those transactions and their effect on the financial statements in 2013, including whether the transactions had been properly presented and disclosed.<sup>36</sup>

50. Instead, Powell and Lawlis improperly concluded that no further analysis of the accounting for the transfers was required after management pointed to language in its loan agreements that it claimed allowed UDF IV to make discretionary advances on a borrower's behalf, in certain limited circumstances, without advance consent from the borrower. Powell and Lawlis accepted management's assertion that the loan agreement provision allowed the UDF Entities to characterize the transfers as third-party loan activity, even though management had initiated the transfers on its own, without any borrower request, and for the express purpose of enabling cash distributions to UDF III's investors.

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<sup>36</sup> See AU §§ 334.02, .09, .11; see also Rule 4-08(k) of Regulation S-X.

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Although Powell and Lawlis read the loan provision that management identified, they did not determine whether the transfers fit into the limited circumstances described in the loan provision or obtain any other evidence to support management's interpretation. They also failed to consider whether the substance of the transaction, regardless of its form, required disclosure as a related party transaction.<sup>37</sup>

Evaluation of Transfers During the 2014 Audits

51. During the 2014 UDF IV audit and reviews, Lawlis became aware that UDF IV made additional transfers to UDF III similar to the January 2014 transfer, but he failed to adequately address them. Lawlis again knew that UDF IV recorded those transfers as third-party loan advances even though there was no evidence of the borrower's request or approval for the transfer. UDF IV also confirmed to Lawlis that it had initiated some transfers to its affiliates without the third-party borrowers' prior consent and obtained approval afterward. Nevertheless, Lawlis again failed to perform sufficient procedures to obtain satisfaction concerning the extent of the transactions and their effect on the financial statements, including whether the transactions had been properly presented and disclosed.<sup>38</sup> For the additional transfers that came to the engagement team's attention, the team either verified that the relevant borrower eventually approved the transaction, or that the loan agreements included the provision for discretionary advances. However, Lawlis again failed to consider whether the substance of the transactions, regardless of their form, required disclosure as a related party transactions.<sup>39</sup>

52. For the 2014 UDF III audit, Powell failed to perform any procedures over the transfers to UDF III from UDF IV.

**H. Powell and Lawlis Failed to Act with Due Professional Care During the Q3 2015 UDF III and UDF IV Reviews**

53. In an interim review, an accountant may become aware of information that leads him or her to believe that the interim financial information under review may not be in conformity with GAAP in all material respects. In such circumstances, PCAOB standards provide that the accountant should make additional inquiries or perform other

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<sup>37</sup> See AU § 334.02.

<sup>38</sup> See AU §§ 334.02, .09, .11; see also Rule 4-08(k) of Regulation S-X.

<sup>39</sup> See AU § 334.02.

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procedures to provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information.<sup>40</sup>

54. If the accountant becomes aware of information which relates to a prior audit report and is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his audit, PCAOB standards also require that he take certain steps concerning his prior report.<sup>41</sup> First, he should determine whether the information is reliable and whether the facts existed at the date of his report.<sup>42</sup> If those conditions are satisfied, the auditor should then consider if the nature and effect of the matter are such that (a) his report would have been affected if the information had been known to him at the date of his report and had not been reflected in the financial statements and (b) he believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the information.<sup>43</sup> The auditor is then required to consider whether to take action to prevent future reliance on his report.<sup>44</sup>

55. As discussed below, during their respective Q3 2015 reviews, Powell and Lawlis became aware of facts indicating material modifications may have been necessary in UDF III's and UDF IV's Q3 2015 financial statements, specifically to the notes receivable balances. That information also cast doubt on UDF III's previously audited annual financial statements. Although Powell and Lawlis performed procedures to respond to those facts for purposes of the Q3 2015 financial statements, they failed to perform those procedures with due professional care.<sup>45</sup> Powell also failed to appropriately consider the possible implications for WP's previously issued audit reports on UDF III's financial statements.<sup>46</sup>

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<sup>40</sup> See AU § 722.22, *Interim Financial Information*.

<sup>41</sup> See AU §§ 561.04-.06, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

<sup>42</sup> See AU § 561.04.

<sup>43</sup> See AU § 561.05.

<sup>44</sup> See AU § 561.06.

<sup>45</sup> See AU § 722.22.

<sup>46</sup> See AU §§ 561.04-.05.

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Powell Failed to Adequately Consider Indications of Potential  
Impairment for the LOC at 2013, 2014, and Q3 2015

56. Before the start of the Q3 2015 reviews, Powell was interviewed by the Commission staff, in connection with its investigation. During the interview, Powell was shown documents and asked questions by the Commission staff that called into question the veracity and accuracy of information that UDF III provided to the WP engagement team in connection with the FY 2013 and 2014 audits concerning the expected cash flows for the LOC. Specifically, Powell was shown documents that, at minimum, raised questions about whether the UDF Entities misstated their cash flow projections for the LOC to conceal its impairment by unilaterally including potential "future projects" in addition to current projects.

57. During the Q3 2015 review, Powell performed procedures to follow-up on the information she learned from the Commission staff, which included inquiries of management and reviewing additional documentation relating to the Commission's investigation and the LOC. Through these procedures, Powell verified that, in March 2014, the Austin Developer had provided its own cash flow projection to the UDF Entities, indicating that it would be unable to repay a substantial portion of its LOC balance. Powell also corroborated that UDF III had modified the version of the projection that it provided to WP for both 2013 and 2014, adding cash flows from "future projects" that the Austin Developer did not own and did not plan to develop.

58. During the review, Powell and the engagement team also quantified the amounts in management's LOC cash flow projections for 2013, 2014, and Q3 2015 that were attributable to existing projects, excluding the amounts attributable to future projects. That analysis showed that, in each of those periods, the cash flows from the existing projects were expected to leave a substantial portion of the LOC unpaid. By Q3 2015, the analysis projected a shortfall of approximately \$73 million,<sup>47</sup> suggesting that material modifications to the interim financial information might be necessary.

59. Despite this information, Powell did not adequately consider whether to withdraw WP's earlier audit reports.<sup>48</sup> Powell also failed to propose that UDF III record any specific reserve for the LOC at Q3 2015 or suspend revenue recognition on the LOC. Instead, Powell concluded that UDF III could file Q3 2015 interim financial statements

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<sup>47</sup> At year-end 2013 and year-end 2014, the projected shortfall indicated by WP's calculation was \$27 million and \$60 million, respectively. The 2013 and 2014 financial statements did not include any specific reserve for the LOC.

<sup>48</sup> See AU §§ 561.04-.05.

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that continued interest revenue recognition from the LOC, contained no specific reserve for the LOC, and included a total ALL for all loans of just \$24.5 million.<sup>49</sup> However, as discussed below, she failed to perform sufficient other procedures to provide a basis for that conclusion.<sup>50</sup>

Powell Inappropriately Relied on Non-Binding Letters of Intent at Q3 2015

60. Powell's conclusion that no specific reserve was required at Q3 2015 was based on three management-provided non-binding letters of intent. One of those letters, dated October 21, 2015, was between the Austin Developer and the UDF Entities and described that the Austin Developer would surrender its collateral in full satisfaction of its debts. The other letters, dated November 12, 2015, were between the UDF Entities and two new developers and described a proposal for new developers to take possession of the LOC collateral, pledge additional collateral, and assume the LOC debt as part of two larger transactions with UDF III.

61. Powell reviewed the letters and discussed them with management. From those discussions, Powell understood that management expected that the transactions described in the letters of intent would occur in late November or early December 2015.

62. After discussing the letters of intent with management, Powell concluded that she would rely upon them for the purpose of evaluating the LOC's impairment for the quarterly review. However, Powell failed to consider with due professional care whether they provided a basis to determine whether a material modification should be made to the interim financial statements to record an impairment for the LOC.<sup>51</sup> For example, Powell did not adequately consider that:

- The letters did not reliably indicate whether the transactions described in the letters would occur, because the letters each stated they were "intended as a non-binding expression of intent" and "subject to the preparation, negotiation and full execution of the agreement"; and

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<sup>49</sup> UDF III management had initially calculated that its Q3 2015 ALL should be \$23.9 million. During the review, Powell performed a calculation of the general reserve portion of UDF III's ALL with different reserve ratios for certain loans, which she based on her discussions with management. Powell's calculation resulted in a total ALL that was approximately \$600,000 higher, and UDF III adjusted its total ALL accordingly.

<sup>50</sup> See AU § 722.22.

<sup>51</sup> See AU § 722.22.

**ORDER**

- The letters did not support that the LOC was properly valued, because they indicated that the UDF Entities would provide as yet unquantified fees and concessions to the new developers for them to take over the LOC and its related development projects.

Powell and Lawlis Failed to Appropriately Respond to New Evidence of a Dispute between the Austin Developer and the UDF Entities at Q3 2015

63. Based on documents they reviewed concerning the Commission's investigation, Powell and Lawlis both understood, among other things, that the Commission staff was examining whether UDF Entities, or persons associated with them, may have made false statements or material omissions about the credit quality of loan portfolios and the use of cash proceeds relating to certain loans.

64. As a result, Powell and Lawlis concluded that it was appropriate to send confirmation requests for all of the Austin Developer's loans as part of their respective Q3 2015 reviews for UDF III and UDF IV. In response to each request, the Austin Developer wrote that it could not confirm its loan balances or loan collateral because "the lender has failed to properly apply or adjust certain payments made on the loan or related loans. In addition, lender and its affiliates have, from time to time, transferred or collaterally assigned their rights with respect to the collateral under various loans to affiliates or third parties."

65. To follow up on the confirmation response, Lawlis emailed the Austin Developer, asking whether it could provide additional information. The response of the Austin Developer, however, provided no additional detail. Powell and Lawlis, in turn, relied on management inquiry to understand the nature of the potential dispute and once again rolled forward the prior year's audited balance by tying a selection of draws and payments to management-provided documents including third-party bank statements and draw requests signed by the borrowers. However, the alternative procedures failed to provide sufficient appropriate evidence about the potential dispute concerning the Austin Developer and whether that dispute affected the loans' valuation. As a result, Powell and Lawlis failed to adequately extend the review procedures to resolve the questions raised by the Austin Developer's confirmation response.<sup>52</sup>

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<sup>52</sup> See AU § 722.22.

**ORDER****I. Babb Failed to Perform His Engagement Quality Reviews for the 2012-2014 UDF III Audits and Q3 2015 UDF III Review with Due Professional Care**

66. The EQR partner is responsible for evaluating 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, if a report is to be issued.<sup>53</sup> In an audit, the EQR partner is responsible for evaluating the engagement team's responses to significant risks identified by the team and the EQR partner.<sup>54</sup> In both audits and reviews, the EQR partner should evaluate whether the documentation that he or she reviewed supports the conclusions reached by the engagement team with respect to the matters reviewed.<sup>55</sup> The EQR partner is also responsible for evaluating whether appropriate consultations took place on difficult or contentious matters during the audits and reviews.<sup>56</sup> The EQR partner must perform his or her responsibilities with due professional care and skepticism.<sup>57</sup>

67. In each of the engagements discussed above, Babb reviewed the critical work papers relating to the UDF III engagement teams' response to the significant risks, including fraud risks, identified concerning notes receivable and ALL. However, Babb violated PCAOB rules and standards in those engagements by failing to properly evaluate, with due professional care, whether that documentation indicated that the engagement team responded appropriately to the significant risks and/or supported the conclusions reached by the engagement team.<sup>58</sup>

68. During the 2012 audit, Babb knew that the LOC was significant to the notes receivable balance and that UDF III management had classified the LOC as impaired without recording any specific reserve. Although Babb reviewed the documentation of the engagement team's testing of the LOC for impairment, there is no evidence he discussed it with the engagement team. Furthermore, he failed to evaluate with due professional care whether that testing adequately supported the conclusion that no specific reserves

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<sup>53</sup> See AS 7, *Engagement Quality Review*, ¶¶ 9, 14.

<sup>54</sup> See AS 7 ¶ 10(b).

<sup>55</sup> See AS 7 ¶¶ 11, 16.

<sup>56</sup> See AS 7 ¶¶ 10(h), 15(f).

<sup>57</sup> See AS 7 ¶¶ 12, 17; AU §§ 230.07-.09.

<sup>58</sup> See Rule 3100; AS 7 ¶¶ 10(b), 11, 16.

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were required for the LOC.<sup>59</sup> For example, Babb did not consider whether the engagement team had tested the completeness and accuracy of the management-provided data used in that test. He also did not consider, among other things, that the engagement team had not discounted the future cash flows to present value for its impairment analysis.

69. During the 2013 and 2014 audits, Babb was aware that the engagement team changed its audit approach from 2012. Specifically, he knew that the engagement teams for those audits used management-provided cash flow projections to test the valuation of certain notes receivable and the adequacy of the ALL, including for the LOC. Babb reviewed the audit documentation describing the review of the cash flow analyses, but he failed to properly evaluate whether the engagement team's approach provided an appropriate response to the significant risks concerning the ALL.<sup>60</sup> For example, Babb did not properly consider whether the engagement team had adequately tested whether the information contained within the cash flow projections was sufficient and appropriate for purposes of the audit. He also did not consider whether the engagement team had appropriately responded to the inclusion of "future projects" in the cash flow projections, in light of the fraud risk for ALL.

70. During the Q3 2015 review, Babb reviewed the engagement team's Summary Review Memorandum ("SRM") and he discussed with Powell the issues that had arisen concerning the LOC.<sup>61</sup> Babb also reviewed each of the documents that were referenced in the SRM as pertaining to the analysis of the LOC's impairment. Those documents included the engagement team's analysis showing that the existing project cash flows would leave approximately \$73 million of the LOC balance unpaid. They also included the non-binding letters of intent, which Babb understood Powell had relied on for her conclusions that the LOC did not need to be specifically reserved at Q3 2015 and that the prior audit reports did not need to be withdrawn. However, Babb failed to properly evaluate whether those letters of intent actually supported Powell's conclusion.<sup>62</sup>

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<sup>59</sup> See AS 7 ¶ 11.

<sup>60</sup> See AS 7 ¶¶ 10(b), 11.

<sup>61</sup> The SRM served as the engagement team's engagement completion document for the Q3 2015 review, which Babb was required to review. See AS 3, *Audit Documentation*, ¶ 13; AS 7 ¶ 15(c).

<sup>62</sup> See AS 7 ¶ 16.

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71. Babb also failed to properly evaluate whether appropriate consultations had taken place on the difficult and contentious issues that arose during the UDF III Q3 2015 review.<sup>63</sup> Babb understood that WP's Partner-in-Charge of Technical Resolution ("Technical Partner") had been consulted during the review. However, Babb failed to determine whether the consultation, which was limited to reviewing the clarity of the documentation in two work papers, was appropriate in the circumstances.

72. As a result, Babb violated AS 7 by providing his concurring approval of issuance in each of those engagements without performing his EQR with due professional care.<sup>64</sup>

**J. Whitley Penn Failed to Comply with PCAOB Quality Control Standards**

73. PCAOB rules and standards require that registered firms establish and maintain an adequate system of quality control.<sup>65</sup> "A firm's system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of complying with professional standards."<sup>66</sup> "The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations."<sup>67</sup>

74. A firm's system of quality control should, among other things, include policies and procedures for engagement performance.<sup>68</sup> A firm should establish policies and procedures to provide it with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory

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<sup>63</sup> See AS 7 ¶ 15(f).

<sup>64</sup> See AS 7 ¶¶ 12, 17; AU § 230.01.

<sup>65</sup> See Rule 3400T, *Interim Quality Control Standards*; Quality Control Standard 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* ("QC § 20").

<sup>66</sup> QC § 20.04.

<sup>67</sup> QC § 20.04.

<sup>68</sup> See QC § 20.07.

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requirements, and the firm's standards of quality.<sup>69</sup> It should also establish policies and procedures to provide it with reasonable assurance that personnel consult, on a timely basis, with individuals within or outside the firm, when appropriate (for example, when dealing with complex, unusual, or unfamiliar issues).<sup>70</sup> A firm should also establish policies and procedures to provide the firm with reasonable assurance that its quality control policies and procedures are suitably designed and are being effectively applied.<sup>71</sup>

75. During the period of the violations described above, WP failed to design, implement and maintain appropriately comprehensive and suitably designed quality control policies and procedures in relation to the firm's size<sup>72</sup> and the complexity of its practice. In particular, WP did not have appropriately comprehensive policies and procedures concerning consultations with persons outside of the engagement team.<sup>73</sup> Although WP designated one of its partners as the Technical Partner, it failed to implement specific policies or procedures concerning the Technical Partner's role. Among other things, there were no established procedures to provide reasonable assurance that the Technical Partner was qualified for the consultations he was asked to perform regarding the complex, unusual and unfamiliar issues that arose during the Q3 2015 UDF III review.<sup>74</sup>

76. WP also failed to design, implement and maintain appropriately comprehensive policies and procedures to provide reasonable assurance that its personnel complied with professional standards and regulatory requirements.<sup>75</sup> Many of the violations described above were repeated across multiple years and, in some cases, across multiple audit teams with different partners. Additionally, Powell's failure to

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<sup>69</sup> See QC § 20.17.

<sup>70</sup> See QC § 20.19. Individuals consulted should have appropriate levels of knowledge, competence, judgment, and authority. See id.

<sup>71</sup> See QC § 20.20; Quality Control Standard 30.02, *Monitoring a CPA Firm's Accounting and Auditing Practice*.

<sup>72</sup> As indicated by the Board's inspection reports, WP grew from having 137 partners and professional staff in 2011 to 248 partners and professional staff by 2015.

<sup>73</sup> See QC § 20.19.

<sup>74</sup> See id.

<sup>75</sup> See QC § 20.17.

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adequately consider whether to withdraw the 2013 and 2014 audit reports during the Q3 2015 review resulted, in part, from WP's failure to have sufficiently comprehensive policies and procedures relating to consideration of subsequently discovered information relating to previously issued audit reports. Multiple partners besides Powell and Babb, including partners in WP's leadership, were aware that WP had learned information during the Q3 2015 review that related to UDF III's 2013 and 2014 financial statements. However, WP's QC system failed to include policies or procedures to provide reasonable assurance that the information was actually evaluated with due professional care and in accordance with AU § 561.<sup>76</sup>

**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 Respondents' Offers. Accordingly, it is hereby ORDERED that:

- A. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Powell 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).<sup>77</sup>
- B. Pursuant to PCAOB Rule 5302(b), Powell may file a petition for Board consent to associate with a registered public accounting firm after two years from the date of this Order.

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<sup>76</sup> WP has represented to the Board that, since the events described in this Order, WP established and implemented the following changes to its quality control processes and procedures: (1) WP hired a full-time Director of Quality Control, (2) WP hired a full-time Learning and Development Coordinator, (3) WP assigned a Senior Manager to its quality control function on a half-time basis, and (4) WP amended its quality control policies and procedures relating to consultations and pre-issuance reviews.

<sup>77</sup> As a consequence of the bar, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Susan Lunn Powell, CPA. 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."

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- C. Pursuant to Section 105(c)(4)(C) of the Act and PCAOB Rule 5300(a)(3), for one year following the termination of the bar ordered in paragraph B, Powell'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: Powell shall not (1) serve, or supervise the work of another person serving, as an "engagement partner," as that term is used in the Board's AS 1201, *Supervision of the Audit Engagement*; (2) serve, or supervise the work of another person serving, as an "engagement quality reviewer," as that term is used in the Board's AS 1220, *Engagement Quality Review*; (3) serve, or supervise the work of another person serving, in any role that is equivalent to engagement partner or engagement quality reviewer, but differently denominated (such as "lead partner," "practitioner-in-charge," or "concurring partner"); (4) exercise authority, or supervise the work of another person exercising authority, either to sign a registered public accounting firm's name to an audit report, or to consent to the use of a previously issued audit report, for any issuer, broker, or dealer; or (5) serve, or supervise the work of another person serving, as the "other auditor," or "another auditor," as those terms are used in the Board's AS 1205, *Part of the Audit Performed by Other Independent Auditors*;
- D. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Lawlis is suspended, for one year from the date of this Order, from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act;<sup>78</sup>
- E. Pursuant to Section 105(c)(4)(C) of the Act and PCAOB Rule 5300(a)(3), for one year following the suspension ordered in paragraph E, Lawlis'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: Lawlis shall not (1) serve, or supervise the work of another person serving, as an "engagement partner," as that term is used in the Board's AS 1201, *Supervision of the Audit Engagement*; (2) serve, or supervise the work of another person serving, as an "engagement quality reviewer," as that term is used in the Board's AS 1220, *Engagement Quality Review*; (3) serve, or supervise the work of another person serving, in any role that is equivalent to engagement partner or engagement quality reviewer, but differently denominated (such as "lead partner," "practitioner-in-charge," or "concurring partner"); (4) exercise authority, or supervise the work of another person exercising

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<sup>78</sup> As a consequence of the suspension, the provisions of Section 105(c)(7)(B) of the Act, discussed *supra*, at n.77, will apply with respect to Jeffrey Shannon Lawlis, CPA.

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authority, either to sign a registered public accounting firm's name to an audit report, or to consent to the use of a previously issued audit report, for any issuer, broker, or dealer; or (5) serve, or supervise the work of another person serving, as the "other auditor," or "another auditor," as those terms are used in the Board's AS 1205, *Part of the Audit Performed by Other Independent Auditors*;

- F. Pursuant to Section 105(c)(4)(C) of the Act and PCAOB Rule 5300(a)(3), for a period of two years from the date of this Order, Babb'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: Babb shall not (1) serve, or supervise the work of another person serving, as an "engagement partner," as that term is used in the Board's AS 1201, *Supervision of the Audit Engagement*; (2) serve, or supervise the work of another person serving, as an "engagement quality reviewer," as that term is used in the Board's AS 1220, *Engagement Quality Review*; (3) serve, or supervise the work of another person serving, in any role that is equivalent to engagement partner or engagement quality reviewer, but differently denominated (such as "lead partner," "practitioner-in-charge," or "concurring partner"); (4) exercise authority, or supervise the work of another person exercising authority, either to sign a registered public accounting firm's name to an audit report, or to consent to the use of a previously issued audit report, for any issuer, broker, or dealer; or (5) serve, or supervise the work of another person serving, as the "other auditor," or "another auditor," as those terms are used in the Board's AS 1205, *Part of the Audit Performed by Other Independent Auditors*;
- G. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), the Board imposes the following civil money penalties:
1. Whitley Penn LLP, \$200,000;
  2. Susan Lunn Powell, \$25,000;
  3. Jeffry Shannon Lawlis, \$15,000; and,
  4. John Griffin Babb, \$10,000.

All funds collected by the Board as a result of the assessment of these civil money penalties will be used in accordance with Section 109(c)(2) of the Act. Respondents shall pay these civil money penalties within ten 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,

**ORDER**

(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 the entity or person 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, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

- H. Pursuant to Section 105(c)(4)(F) of the Act and PCAOB Rule 5300(a)(6), Powell, Lawlis, and Babb, are required to complete continuing professional education ("CPE") in subjects that are related to the audits of issuer financial statements under PCAOB standards (such hours shall be in addition to, and shall not be counted in, the CPE they are required to obtain in connection with any professional license) as follows:
1. Powell shall complete forty additional hours of CPE before filing any petition for Board consent to associate with a registered public accounting firm, including CPE related to allowances for loan losses and the auditing of related party transactions under PCAOB standards;
  2. Lawlis shall complete twenty additional hours of CPE within one year of this Order, including CPE related to allowances for loan losses and the auditing of related party transactions under PCAOB standards; and
  3. Babb shall complete ten additional hours of CPE within one year from the date of this Order, including CPE related to allowances for loan losses and the performance of engagement quality reviews under PCAOB standards.
- I. Pursuant to Sections 105(c)(4)(F) and (G) of the Act and PCAOB Rules 5300(a)(6) and (9), the Firm shall carry out the following Undertakings:
1. Within 30 days of the date of this Order, WP shall retain and pay the fees and reasonable expenses for an independent consultant acceptable to the PCAOB staff who has experience with, and is knowledgeable concerning, PCAOB auditing and quality control standards ("Independent Consultant") and promptly notify the PCAOB staff of the identity, qualifications, and proposed terms of retention of the Independent Consultant.
  2. To ensure the independence of the Independent Consultant, WP: (i) shall not have the authority to terminate the Independent Consultant

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or substitute another independent consultant for the initial Independent Consultant, without the prior written approval of the PCAOB staff; and (ii) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

3. WP shall cooperate fully with the Independent Consultant and shall provide reasonable access to its personnel, information, and records as the Independent Consultant may reasonably request for the Independent Consultant's evaluation and certification.
4. Within 90 days of this Order, WP will review, evaluate, and implement any necessary enhancements to, WP's quality control policies and procedures applicable to audits and reviews conducted pursuant to PCAOB standards as they relate to the following areas:
  - a. consideration of the subsequent discovery of facts existing at the date of the auditor's report;
  - b. consultations (including but not limited to determining and documenting the scope of consultations, and the evaluation of such consultations by an EQR partner); and
  - c. monitoring (including selection of audits for pre-issuance review, root cause analysis, post-issuance review, or other enhanced monitoring based on engagement risk).
5. *Independent Consultant Certifications.*
  - a. Within 90 days of the Independent Consultant being retained, WP will brief the Independent Consultant regarding: (i) WP's review, evaluation and implementation of enhancements to its system of quality control in the areas identified in Paragraph IV.I.4 above, and (ii) how those quality control policies and procedures, and any enhancements to them since the time of the conduct described in this Order, are reasonably designed to ensure that WP system of quality control is appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

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- b. Within 120 days of the Independent Consultant being retained, WP shall require the Independent Consultant to evaluate WP's review, evaluation and implementation of enhancements its system of quality control in the areas identified in Paragraph IV.I.4, above. If, as a result of that evaluation, it appears to the Independent Consultant that any further enhancements to the system of quality control are necessary, it shall recommend such enhancements to WP.
- c. Within 180 days of the Independent Consultant being retained, WP shall either, (1) implement any recommendations received from the Independent Consultant, pursuant to Paragraph IV.I.5.b, and have the Independent Consultant certify that WP complied with those recommendations, or (2) communicate to the Director of the Division of Enforcement and Investigations the recommendations of the Independent Consultant that it did not implement, and the reasons for doing so.
- d. Pursuant to Section 105(c)(4)(C) of the Act, Whitley Penn shall within twelve months of the date of the Order cause the Independent Consultant to certify in writing to the Director of the Division of Enforcement and Investigations, PCAOB, 1666 K Street N.W., Washington DC 20006, the Firm's compliance with the above paragraphs. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The certification shall include a description of the specific enhancements implemented to WP's system of quality control in the areas identified in Paragraph IV.I.4, above, since the time of the conduct described in the Order. WP shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement and Investigations may reasonably request.
- e. For good cause shown, the PCAOB staff may extend any of the procedural dates relating to these undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

**ORDER**

- f. WP agrees that the Division of Enforcement and Investigations may petition the Board to reopen this matter to determine whether additional sanctions or findings are appropriate if it believes that WP has not satisfied these undertakings.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

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Phoebe W. Brown  
Secretary

March 24, 2020