

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO ACT, 2017

APPEAL COMMITTEE

IN THE MATTER OF: An appeal by **STEPHEN W.A. WALL, CPA, CA** of the Decision of the Discipline Committee, made March 20, 2017, and Order, made October 6, 2017, under Rule 24 of the Rules of Practice and Procedure.

TO: Mr. Stephen Wall, CPA, CA

AND TO: The Professional Conduct Committee

DECISION AND ORDER MADE JULY 19, 2019

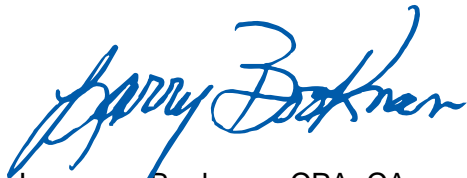
DECISION

The Tribunal, having heard and considered the submissions of the parties, dismisses the appeal and upholds the sanctions as Ordered by the Discipline Committee on October 6, 2017.

ORDER

The Professional Conduct Committee is directed to make any submissions on costs in writing by Monday, July 29, 2019, not exceeding five pages excluding the costs outline. The Member may make responding submissions with respect to costs in writing within 10 days of the receipt of the submissions of the Professional Conduct Committee, also not to exceed five pages, excluding a costs outline, if any. The Professional Conduct Committee may make reply submissions within 5 days after receiving the Member's submissions, not to exceed two pages.

DATED at Toronto this 19th day of July, 2019



Laurence Bookman, CPA, CA
Appeal Committee – Chair

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
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IN THE MATTER OF: An appeal by **STEPHEN W.A. WALL, CPA, CA** of the Decision of the Discipline Committee, made March 20, 2017, and Order, made October 6, 2017, under Rule 24 of the Rules of Practice and Procedure.

BETWEEN:

Stephen W. A. Wall

-and-

**Chartered Professional Accountants of Ontario
Professional Conduct Committee**

APPEARANCES:

For Mr. Wall:	Cynthia Amsterdam, Counsel Timothy A. Duffy, Counsel Emily Nicklin, Counsel (not appearing on the appeal)
For the Professional Conduct Committee:	Paul F. Farley, Counsel Brian Bellmore, Counsel
Heard:	August 14, 15, 16 and 17, 2018 and October 4 and 5, 2018
Decision and Order effective:	July 19, 2019
Release of written reasons:	July 19, 2019

REASONS FOR DECISION AND ORDER MADE JULY 19, 2019

- [1] Stephen W.A. Wall ("Mr. Wall") appeals the Decision of the Discipline Committee of the Chartered Professional Accountants of Ontario ("Discipline Committee") dated March 20, 2017 and the Final Order dated October 6, 2017. This appeal was heard by a Panel of the Appeal Committee of the Chartered Professional Accountants of Ontario ("Appeal Committee").
- [2] The appeal is dismissed. The following are the reasons of the Appeal Committee.

I. OVERVIEW

- [3] The hearing on the merits commenced on September 15, 2014 before the Discipline Committee. At the commencement of the proceedings, Mr. Wall entered a plea of not guilty to two allegations of professional misconduct made by the Professional Conduct Committee (“PCC”) of the Chartered Professional Accountants of Ontario (“CPA Ontario”).
- [4] The two issues before the Discipline Committee were essentially whether Mr. Wall had complied with the applicable auditing standards when he accepted the information (confirmations) provided by Bernard L. Madoff Securities Limited, LLC (“BLMIS”) regarding the assets of and income for Fairfield Sentry Limited (“Fairfield Sentry”) for the years ending December 31, 2006 and December 31, 2007.
- [5] On March 20, 2017, the Discipline Committee concluded that Mr. Wall failed to comply with the applicable auditing standards, i.e. United States Generally Accepted Auditing Standards (U.S. GAAS) and as a result, there was an audit failure. The Discipline Committee went on to conclude that the allegations against Mr. Wall had been proven and that Mr. Wall was guilty of professional misconduct.
- [6] As this appeal hearing was commenced on August 14, 2018, any references in the decision herein are to the CPA Ontario bylaws, regulations and Rules of Practice and Procedure in effect prior to November 19, 2018.
- [7] Any reference to documentary evidence prefixed by “AU” relates to professional standards sections deriving from the American Institute of Certified Public Accountants’ (“AICPA”) *Statements on Auditing Standards* (“SAS”).

II. PRELIMINARY MOTIONS ON THE APPEAL

- [8] On the first day of the appeal, Mr. Wall brought a motion without notice seeking a variety of relief, specifically:
 - i. an Order requiring the Appeal Committee members to recuse themselves from presiding on this appeal, and
 - ii. an Order adjourning the commencement of the appeal hearing to reconstitute the Appeal Committee with 4 CPA, CA panel members who are duly qualified, experienced auditors, together with 1 public representative in good standing and in compliance with his professional or regulatory body.
- [9] Counsel for the PCC consented to the motion proceeding despite late service of the notice of motion.
- [10] Mr. Wall submitted that the Appeal Committee members were not duly qualified to preside over the hearing of the appeal. More specifically, Mr. Wall argued that the Appeal Committee members did not have the requisite audit background in foreign auditing standards or with auditing brokers/dealers to properly understand the issues under appeal. Mr. Wall also raised concerns regarding alleged potential racial and

religious bias on the part of particular members of the Appeal Committee, as well as questioning whether other members of the Appeal Committee were properly qualified to preside on this tribunal, given that one public member was suspended administratively by his regulator.

- [11] The *Chartered Professional Accountants of Ontario Act*, 2017, S.O. 2017, c.8, Schedule 3 (“the Act”), its Bylaws and Regulation 7-3, s.35, do not require tribunal members to have industry specific experience or experience with the relevant audit standards. The Appeal Committee was comprised of three experienced and duly qualified CPAs, one of whom holds a public accounting licence and sharing the same legacy designation as Mr. Wall, as well as two public representatives. The Appeal Committee concluded that the Appeal Committee was properly constituted under s.13 of the *Act*, the Bylaws and Regulation 7-3, section 35.
- [12] Mr. Wall raised concerns regarding racial and religious bias on the part of Appeal Committee members based on alleged comments made by unspecified members of the Appeal Committee on social media. Mr. Wall presented no evidence to support the alleged comments. Despite the lack of evidence, the members of the Appeal Committee were individually challenged by the Chair on their ability to properly serve on this Panel in an unbiased and unprejudiced manner. The Appeal Committee also considered whether each member was able to continue in a completely unbiased manner, in light of the challenges made and concerns raised by Mr. Wall. The Appeal Committee determined that each member was capable of properly serving on the Committee and each member was confident that they could continue to hear the appeal and to render a decision in an unbiased manner.
- [13] Mr. Wall's motion seeking to recuse the Appeal Committee for alleged lack of qualifications and for alleged bias was dismissed.

III. THE DISCIPLINE COMMITTEE DECISION

- [14] The two allegations the Discipline Committee had to determine were whether, for the two years ending December 31, 2006 and December 31, 2007, Mr. Wall, an engagement partner with PricewaterhouseCoopers LLP (PwC), had complied with the applicable auditing standards when he accepted the information (confirmations) provided by BLMIS regarding the assets of and income for Fairfield Sentry, a company incorporated under the laws of the British Virgin Islands.
- [15] In order to determine whether Mr. Wall had engaged in the alleged conduct, the Discipline Committee had to consider whether Mr. Wall had engaged in conduct as particularized in the two allegations of professional misconduct, dated October 12, 2012. The particulars of both allegations were nearly identical and alleged that Mr. Wall had:
 - i. failed to properly plan the audit;
 - ii. failed to identify the role of BLMIS in providing the discretionary investment management/advisory function to Fairfield Sentry, as that of a third party “service organization” and a key audit area for which an audit response was necessary;

- iii. failed to exercise sufficient and appropriate professional skepticism;
 - iv. failed to appropriately consider and audit the risk of material misstatement of Fairfield Sentry's financial statements through fraud, due to the presence of numerous fraud risk factors;
 - v. failed to appropriately consider and audit the increased risk of material misstatement of the financial statements due to approximately \$7.0 billion or 95% of the net assets of the company being held by a third party "service organization" that provided not only the investment management/advisory function but also the prime broker-dealer and sub-custodial functions for these assets;
 - vi. failed to obtain sufficient and appropriate audit evidence of the operating effectiveness of the internal controls of BLMIS, Fairfield Sentry's outside "service organization";
 - vii. failed to obtain sufficient and appropriate audit evidence to support the balance sheet item "Financial assets at fair value through profit or loss \$5,555,567,000 for the year ended December 31, 2006" and "\$7,173,165,000 for the year ended December 31, 2007";
 - viii. failed to obtain sufficient and appropriate audit evidence to support the income statement line item "Net gains on financial assets and liabilities at fair value through profit or loss \$549,938,000 for the year ended December 31, 2006" and "\$624,752,000 for the year ended December 31, 2007".
- [16] The Discipline Committee heard 43 days of evidence and motions, as well as having received and reviewed submissions by counsel, both orally and in writing.
- [17] Mr. Harris Devor CPA (U.S.) was the investigator and expert called by the PCC. Dr. Gary Holstrum Ph.D., CPA (Florida), CFE, CFF, CIDA was also called by the PCC as an expert. Mr. Anthony DeAngelis CPA (U.S.) was called by Mr. Wall as an expert, as was Ms. Jennifer Hull, CPA (U.S.). Ms. Patricia Perruzza, CA, and Mr. Derek Hatoum, CA, both with PwC, testified on behalf of Mr. Wall. Mr. Robert Richter, CPA (Pennsylvania), was an experienced broker-dealer auditor retained by the PCC to provide an opinion. He was not called to testify as he was unwell at the time; however, Mr. Wall submitted Mr. Richter's report into evidence.
- [18] Having heard the evidence presented by both the PCC and Mr. Wall, the Discipline Committee concluded that Mr. Wall had failed to comply with U.S. GAAS when he accepted the information (confirmations) provided by BLMIS about the assets of and net gains set out in the income statements ("income") for Fairfield Sentry for the years ended December 31, 2006 and December 31, 2007. As a result, there was an audit failure.
- [19] In order to come to that determination, the Discipline Committee found that particulars (i), (iii), (v), (vi), (vii) and (viii) of both allegations as set out in paragraph 15 above, were proven. Particulars (ii) and (iv) of both allegations were not proven.

- [20] The Discipline Committee noted that a finding that Mr. Wall had engaged in any of the conduct as particularized above, in and of itself would constitute professional misconduct.
- [21] As a result of the determinations made by the Discipline Committee, Mr. Wall was found guilty of professional misconduct.

IV. THE APPEAL OF THE MEMBER

- [22] In this appeal, Mr. Wall sought the following relief from the Appeal Committee:
- i. an Order setting aside the Order of the Discipline Committee finding Mr. Wall guilty of professional misconduct and the sanctions levied against him;
 - ii. an Order finding that Mr. Wall is not guilty of Allegations 1 and 2, and all the particulars thereof; and
 - iii. an Order that there be no order of costs as against Mr. Wall.

V. THE STANDARD OF REVIEW

- [23] Section 37(4) of the *Act* empowers the Appeal Committee to determine any question of law or mixed fact and law that arises in an appeal. That power however is limited by s.37 (5) of the *Act*, which prohibits the Appeal Committee from making a decision under section 37(4)(a) or (b) of the *Act* unless the Appeal Panel determines that the decision or order of the Discipline Committee is “unreasonable”.
- [24] Regulation 7-3 under the *Act*, directs the Appeal Committee not to rehear the matter, but rather directs the Appeal Committee to decide whether, on the record, the final decision and order of the Discipline Committee are reasonable on the evidence and on the law.
- [25] Reasonableness is a deferential standard. While a review for reasonableness requires the reviewing body to consider whether the reasons given disclose a decision making process which contains “justification, transparency and intelligibility”, it also recognizes that a decision may not lead to one and only one conclusion, but rather, may fall within a range of possible, acceptable conclusions (*Dunsmuir v. New Brunswick*, 2008 SCC 9 (CanLII), [2008] 1 S.C.R. 190, para.47). Even if the decision of the Discipline Committee is not one which the Appeal Committee would have made, if the decision falls within a range of possible acceptable outcomes and identified the analysis leading to that decision, the Appeal Committee shall not interfere.
- [26] A Discipline Committee is not expected to address every piece of evidence or address every submission made before it in its reasons. “The reasons for decision in professional discipline cases must address the major points in the case” providing “the path” taken by the Discipline Committee in reaching its ultimate conclusion. The Discipline Committee is not however, required to “describe every landmark along the way” (*Barrington v. Institute of Chartered Accountants (Ontario)*, 2011 ONCA, 409, para.114).

VI. OVERVIEW OF THE SUBMISSIONS AND ARGUMENTS

- [27] Over 5 ½ days, the Appeal Committee heard submissions from both Mr. Wall and the PCC. The Appeal Committee reviewed both written submissions and materials in support and had access to the complete record before the Discipline Committee, including the transcripts of the evidence heard by the Discipline Committee. In the midst of the Appeal Committee's deliberations, the Appellant submitted the case of *Kenneth Melvin Kryz et al v. PricewaterhouseCoopers Accountants N.V. et al* C/13/21460/HA ZA 12-863 for the Panel's consideration. The Respondent did not object and provided its position regarding the relevance of the decision. The Appeal Committee considered this material as well.

Submission on behalf of Mr. Wall

- [28] Counsel for Mr. Wall argued that the Decision of the Discipline Committee was unreasonable in light of the evidence presented at the hearing before the Discipline Committee and the applicable legislation. Moreover, Mr. Wall argued that the Reasons of the Discipline Committee were insufficient and therefore could not support the Decision.
- [29] In his factum and as argued on appeal, Mr. Wall submitted that the Discipline Committee's Decision erred by:
- i. Failing to appropriately consider that the allegations against Mr. Wall and the evidence submitted by the PCC against him were the product of a substantively deficient investigation owing to Mr. Devor's lack of experience, skill, bias, and his improper advocacy on behalf of the PCC;
 - ii. Failing to appropriately consider Mr. Wall's evidence with respect to the audit work performed and the evidence obtained regarding the effective operation of BLMIS' key internal controls with respect to the functions performed by BLMIS for Fairfield Sentry, including, but not limited to, BLMIS's Rule 17a-5 Report;
 - iii. Failing to appropriately consider the evidence of the common practice of other audit professionals in similar circumstances with respect to the audit considerations and procedures required by U.S. GAAS;
 - iv. Improperly crediting the testimony of the PCC's experts, including Mr. Devor who had a conflicted role as investigator and expert, and who both had no relevant audit experience or skill, improperly ignoring the contrary evidence of Mr. Richter, and improperly ignoring or discounting the testimony of Mr. Wall, the audit team, and Mr. Wall's expert witnesses;
 - v. Improperly concluding that the PCC had met its burden of proving that Mr. Wall's audit work failed to comply with the requirements of U.S. GAAS and instead misinterpreting and misapplying the provisions of U.S. GAAS so as to impose upon Mr. Wall requirements not found therein with which it would have been impossible for him or any other auditor to comply with; and

- vi. Improperly concluding that any ostensible failure by Mr. Wall to comply with U.S. GAAS was sufficient to support a finding of professional misconduct on the part of Mr. Wall.

Submission on behalf of the PCC

- [30] The PCC argued that the Decision of the Discipline Committee was reasonable and that the Reasons given provided the basis for the Decision and should not be interfered with by the Appeal Committee.
- [31] The PCC relied on a number of factual determinations made by the Discipline Committee in support of its finding that Mr. Wall had failed to perform his professional services in accordance with the generally accepted standards of practice of the profession when he accepted the information (confirmations) provided by BLMIS about the assets of and income for Fairfield Sentry. Those factual determinations were the following:
 - i. BLMIS was a service organization.
 - ii. Mr. Wall and the audit team failed to make an appropriate audit response to BLMIS being a service organization at the time the audit reports were released.
 - iii. The auditor did not rely on the SEC 17a-5 Reports at the time the audit reports were released.
 - iv. In the alternative, assuming Mr. Wall did use the SEC 17a-5 Reports as audit evidence, the Discipline Committee found that these SEC 17a-5 Reports could not provide sufficient evidence to support the operating effectiveness of internal controls at BLMIS to comply with U.S. GAAS.
 - v. The auditor could not rely on the BLMIS confirmations as BLMIS was not independent of Fairfield Sentry.
- [32] The PCC asked the Appeal Committee to dismiss Mr. Wall's appeal.

VII. KEY ISSUES AND GROUNDS OF APPEAL CONSIDERED BY THE APPEAL COMMITTEE

- [33] In the Appeal Committee's view, the grounds of appeal as set out by Mr. Wall in his factum are most logically considered within the framework of the audit process undertaken by Mr. Wall. This analysis will follow the audit process undertaken by Mr. Wall with reference to the grounds as they relate to the Appeal Committee's findings.

A. Failure to Appropriately Consider Mr. Wall's Audit Evidence (Ground ii)

i. Failure to Properly Plan the Audit

- [34] Before the Discipline Committee, the PCC argued that Mr. Wall failed to properly plan the audit when he failed to identify BLMIS as a service organization and failed to plan an appropriate audit response. The PCC went on to argue that he did not meet the required standards under U.S. GAAS.
- [35] Mr. Wall had denied the allegation that he failed to properly plan the audit. Mr. Wall also argued in the alternative that even if he failed to follow the standards of the profession, it was an error in judgment which does not constitute professional misconduct.
- [36] The Discipline Committee concluded that Mr. Wall had failed to properly plan the audits. The Discipline Committee found that in planning these audits, despite identifying the various roles or functions that BLMIS provided to Fairfield Sentry, Mr. Wall did not provide an appropriate audit response. Having found that PwC had identified that BLMIS provided discretionary investment advisory/management services, dealer-broker and sub-custodial services to Fairfield Sentry, the Discipline Committee concluded that although it was not critical that PwC label BLMIS as a service organization in its audit planning, it was essential that in its audit planning the audit team provide an appropriate audit response in these circumstances. The Discipline Committee then went on to find that BLMIS' systems were an integral part of Fairfield Sentry's information systems requiring PwC to gain an understanding of the internal controls at BLMIS and to gather sufficient appropriate audit evidence of the operating effectiveness of the key internal controls upon which they intended to rely, including the segregation of departments.
- [37] In his second ground of appeal, Mr. Wall argued that the Discipline Committee erred by failing to properly consider the evidence before it relating to audit planning and then erred by concluding that Mr. Wall had failed to properly plan the audits.
- [38] The Discipline Committee considered the opinion of Mr. DeAngelis, an expert witness called by Mr. Wall, who held that BLMIS was not a service organization because Fairfield Sentry had sufficient input and control over the investment decision making process. The Discipline Committee did not find this conclusion plausible in light of the fact that BLMIS did not share the details of its split/strike strategy nor did Fairfield Sentry control the timing of leaving and re-entering the market.
- [39] The Discipline Committee accepted the evidence of Mr. Wall, Ms. Perruzza, Mr. Hatoum, as well as Mr. Devor and Dr. Holstrum, who all agreed that BLMIS met the criteria as set out in AU324.03 that identify it as a service organization and acknowledged that Mr. Wall was required to gain an understanding of the internal controls at BLMIS and obtain sufficient appropriate audit evidence of the operating effectiveness of the controls.
- [40] Before the Discipline Committee, Mr. Wall testified that he had provided an appropriate audit response acknowledging that BLMIS was a service organization to Fairfield Sentry. In these circumstances, he had gained an understanding of the internal controls at BLMIS through his review of the memorandum from PwC Bermuda and discussion with Mr. Watson-Brown and he relied on the SEC 17a-5 Report prepared by BLMIS'

independent auditors, Friehling & Horowitz (“F&H”), as evidence of the effective operation of the internal controls at BLMIS through his review of the work done with FGG and Fairfield Sentry ([DC Decision, para.80](#)). Moreover, the Discipline Committee found the working papers documenting the audit planning to be inadequate and concluded that “(t)here is no working paper which evidences that Mr. Wall and the PwC audit team did intend from the outset of each audit, or even at the time the 2007 audit was released, to rely on the 17a-5 Reports or that it was essential to test the effectiveness of the key internal controls of BLMIS” ([DC Decision, para. 142](#)).

- [41] The SEC 17a-5 Report referred to by the Discipline Committee is the *SEC 17a-5 Report-Independent Auditor’s Report on Internal Control and Proof of Financial Condition* which had been prepared by F&H, who had been retained by BLMIS to audit the operating effectiveness of the internal controls of BLMIS. As stated at the end of F&H’s *Independent Auditor’s Report on Internal Control*, “(t)his report is intended solely for the information and use of the Company’s management, the SEC, the National Association of Securities Dealers, Inc. and other regulatory agencies that rely on rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties” (Tab 230 of the Appeal Book).
- [42] Based on the evidence considered at the hearing, the Discipline Committee concluded that a SEC 17a-5 Report is not the equivalent of a SAS 70 Report. A SAS 70 Report states that it is evidence of the effectiveness and reliability of the system of internal controls of a service organization required by U.S. GAAS, and is intended for the use of the service organization’s management, its clients and independent auditors of its clients ([DC Decision, para.129](#)) (Tab 225 of the Appeal Book).
- [43] Whether Mr. Wall was entitled to rely upon the SEC 17a-5 Report as proof of the operating effectiveness of the internal controls at BLMIS as opposed to relying upon a SAS 70 Report which was not prepared for BLMIS, was a key issue before the Discipline Committee.
- [44] In support of its finding, the Discipline Committee observed at paragraph 144 of its Decision that “(t)here is reference in the audit plans regarding BLMIS that ‘we will perform transaction testing on the investment strategy applied by Bernard Madoff for the applicable Funds’ but no reference is made, in either year, to a 17a-5 Report” ([DC Decision, para.144](#)).
- [45] Having concluded that the SEC 17a-5 Reports had not been included as part of the audit plan, the Discipline Committee found that “(w)hile there is an issue about if and when the PwC audit team decided that it would and could rely on the 17a-5 Reports as sufficient appropriate evidence of the operating effectiveness of internal controls at BLMIS, there was no question about their position at the hearing” ([DC Decision para.134](#)). Specifically, the audit team testified at the hearing that they **had** relied upon the SEC 17a-5 Reports as evidence of the operating effectiveness of the internal controls at BLMIS.
- [46] The Discipline Committee accepted the evidence of the PwC audit team, that they **were** relying on the SEC 17a-5 Reports, as evidence of the operating effectiveness of the internal controls at BLMIS. However, the Discipline Committee found the PwC audit

team's reliance on the SEC 17a-5 Reports to be inadequate audit evidence as discussed in greater detail below.

- [47] Moreover, the Discipline Committee went on to find that Mr. Wall planned to rely upon the confirmations of assets and related income from BLMIS. There was no evidence that Mr. Wall obtained sufficient audit evidence of the effective operation of key internal controls at BLMIS. Such evidence was essential before Mr. Wall could rely on the confirmations received from BLMIS. The Discipline Committee listed 7 specific reasons or findings to support this conclusion as set out in paragraph 51 below.
- [48] The Appeal Committee finds that the Discipline Committee clearly explained in its Decision how it reached the conclusion that Mr. Wall did not adequately plan the Fairfield Sentry audit. The Appeal Committee considers the decision of the Discipline Committee to be reasonable in light of all the evidence presented at the discipline hearing, including the evidence of Mr. Wall, as well as the opinion evidence of all witnesses. The PwC audit team ultimately recognized that BLMIS was a service organization with respect to Fairfield Sentry as it provided investment advisory services, dealer-broker services and sub-custodial services as contemplated by "AU 324 Service Organizations" of the U.S. GAAS.
- [49] The Discipline Committee specifically states that if the audit plans did not require evidence of the operating effectiveness of the internal controls at BLMIS, the audits were not properly planned and that neither Mr. Wall's reliance on the SEC 17a-5 Report nor his transaction testing discussed below, was an appropriate audit response ([DC Decision para.140](#)). In light of the failure to design an appropriate audit response after identifying BLMIS was a service organization to Fairfield Sentry, the audit planning was inadequate and led to an audit failure.

ii. Failure to Obtain Sufficient Audit Evidence

- [50] Having concluded that BLMIS was a service organization with respect to the audit of Fairfield Sentry, a concession also made by Mr. Wall, the Discipline Committee went on to consider the sufficiency of the audit evidence of the operating effectiveness of the key internal controls at BLMIS.
- [51] The Discipline Committee concluded that Mr. Wall did not have any evidence that the key internal controls of BLMIS were operating effectively. Such evidence was essential before Mr. Wall could rely on the confirmations provided by BLMIS. BLMIS was not independent of Fairfield Sentry, and consequently the Discipline Committee concluded that Mr. Wall could not rely on the confirmations. In coming to this conclusion, the Discipline Committee identified seven specific reasons or findings to support its conclusion that the SEC 17a-5 Reports were not sufficient appropriate audit evidence of the effective operation of key internal controls at BLMIS:
- 1) The only evidence that PwC could suggest that established the effective operation of the key internal controls at BLMIS are the 17a-5 Reports.

- 2) The prohibition of use set out in the 17a-5 Reports, precluded their use by PwC.
- 3) The 17a-5 Report, as it states, “is intended solely for the information and use of the Company’s management, the SEC, the National Association of Securities Dealers, Inc.” The 17a-5 Report (and the Statement of Financial Condition) are evidence of regulatory compliance.
- 4) As covered in the Report of Dr. Holstrum, the 17a-5 Report is not equivalent to a SAS 70 Report, a report which is intended for the use of the management, its clients and the independent auditors of its clients. A SAS 70 Report, not a 17a-5 Report, is evidence of effective operation of internal controls required by US GAAS for the audit of financial statements by the independent auditors.
- 5) Assuming that the 17a-5 Report could potentially be used by PwC, there was no evidence in PwC working papers that the conditions, which AU 543.10 required before Mr. Wall could use the report certified by another auditor had been satisfied.
- 6) No reliance could be placed on the 17a-5 Report certified by BLMIS’s auditors, Friebling & Horowitz, as PwC did not obtain any evidence of reliability of the tests performed and the results thereof as required by AU 543.12.
- 7) Whether or not the BLMIS-Fairfield Sentry relationship does fall within Scenario C of Chapter 9 of the Audit Guide (Dr. Holstrum opined that it did not and Mr. Wall had to look to GAAS) the requirements set out in 9.28 and 9.30 and footnote 7 of the Audit Guide for auditing derivatives instruments hedging activities and investment in securities were not satisfied.

(DC Decision para. 129)

- [52] Mr. Wall maintained that he used copies of the SEC 17a-5 Reports and the Statements of Financial Condition as evidence of the operating effectiveness of the key internal controls with respect to segregation of duties at BLMIS.
- [53] In reaching its conclusion that the SEC 17a-5 Reports were not sufficient appropriate audit evidence to satisfy the requirements of a U.S. GAAS audit, the Discipline Committee relied upon the opinions of the two PCC expert witnesses, Dr. Holstrum and Mr. Devor.
- [54] The Discipline Committee specifically noted that, at page 55 of Dr. Holstrom’s report, under the heading “Failing to Respond Appropriately to the Role of Mr. Madoff and BLMIS in Fairfield Sentry’s System and to Obtain Sufficient Appropriate Evidence of the Effectiveness of BLMIS Control”, Dr. Holstrum concluded:

Mr. Wall departed from GAAS when he decided not to test controls at BLMIS or obtain a SAS 70 Report on those controls but instead relied on an SEC 17a-5 Report. This resulted in his failure to obtain

sufficient appropriate audit evidence of the effectiveness of BLMIS controls that played a critical role as part of Fairfield Sentry's information system for financial reporting and a failure to comply with the requirements of GAAS established in SAS 70 (AU 324) *Service organizations*.

(DC Decision, para. 60a)

- [55] The Discipline Committee considered Mr. Devor's opinion to a similar effect: "Mr. Devor opined that the 17a-5 Report did not provide sufficient appropriate audit evidence (evidential matter) of the operating effectiveness of the internal controls at BLMIS, that it was not the equivalent of a US *Statement on Auditing Standards No. 70 Report on Controls Placed in Operation and Tests of Operating Effectiveness* ("SAS 70 Report")" (DC Decision, para. 51).
- [56] Mr. Wall also argued that the Discipline Committee failed to consider the report prepared by Mr. Richter, an expert retained by the PCC. While he had prepared a four-page report for the PCC, the PCC did not call Mr. Richter at the hearing as he was unwell. The PCC did not seek to rely upon his report. Mr. Wall also did not call Mr. Richter but rather introduced the report at the hearing and relied upon Mr. Richter's position that "(t)he purpose of the (SEC 17a-5) Report and the reason it is required is to provide broker-dealer customers and regulators with independent attestation as to the effectiveness of the broker-dealer's internal controls."
- [57] As he was not called as a witness at the hearing, Mr. Richter's assertions were not subjected to the rigors of cross examination. It was open to the Discipline Committee, having heard all the evidence presented by the parties, to decide what if any weight it would give to Mr. Richter's report (Exhibit 3862 of the Discipline Hearing).
- [58] The evidence before the Discipline Committee, considered in its totality, reveals that there is in fact no conflict between Mr. Richter's report and Mr. Devor's testimony. Both concluded that SEC 17a-5 Reports were not sufficient appropriate audit evidence of the effectiveness of the internal controls at BLMIS as required by U.S. GAAS. This is clear in Mr. Richter's report where he states:
- Obtaining and reading a Rule 17a-5 report does not satisfy the requirements of GAAS as set forth in AU 324 and AU 332 and Chapter 9 of AICPA Audit Guide, *Auditing Derivative Instruments, Hedging Activities and Investment Securities*, and under section 9.24 through 9.30 of such guide regarding "obtaining evidential matter about the operating effectiveness of the broker-dealer's controls.
- [59] The Discipline Committee went on to find that Mr. Wall did not satisfy the requirements set out in sections 9.28 and 9.30 and footnote 7 of the AICPA Audit Guide regarding the obtaining of evidential materials of the operating effectiveness of the broker-dealer's controls.
- [60] The Discipline Committee also noted that the SEC 17a-5 Reports clearly state that the SEC 17a-5 Report "is intended solely for the information and use of the Company's management, the SEC, the National Association of Securities Dealers, Inc." (DC

[Decision, para. 119](#)). The Discipline Committee went on to find that the reliance upon the SEC 17a-5 Report was inappropriate for these particular audits ([DC Decision, para.120](#)).

- [61] The Discipline Committee, in referring to Mr. Devor's evidence, noted that "(h)e was also of the view that by its terms Mr. Wall was precluded from relying on the 17a-5 Report and in any event Mr. Wall had not satisfied the conditions of AU 543.10 for an auditor to rely on the work of another auditor" ([DC Decision, para. 51](#)).
- [62] The Discipline Committee noted that under AU 543.10, in order for Mr. Wall to place any reliance on the SEC 17a-5 Reports, he was required, among other things, to inquire about the professional reputation and standing, as well as obtain a representation from F&H that they were independent of BLMIS. The Discipline Committee considered the evidence of Mr. Wall's expert, Mr. DeAngelis who testified that "the discussion Mr. Wall had with Dan Lipton¹ satisfied the requirements of AU 543 that in order to use the report of another auditor Mr. Wall had to make inquiries as to that auditor's professional reputation and discuss the audit procedures followed by the other auditor and the results thereof" ([DC Decision, para. 97](#)).
- [63] The Discipline Committee considered the exchange between Mr. Lipton and Mr. Wall, noting that Mr. Lipton had essentially advised Mr. Wall that F&H was a niche audit firm in the broker-dealer industry. Contrary to Mr. DeAngelis' opinion, the Discipline Committee found that this "second hand information" was insufficient evidence of professional reputation. In considering the steps taken by Mr. Wall, the Committee noted that Mr. Wall "did not even check with the AICPA to see if Friebling & Horowitz were licensed to perform audits in New York State, which he could have done with a search from his computer." ([DC Decision, para. 149](#)) The Discipline Committee found that a more robust investigation of the audit firm that signed the reports that Mr. Wall relied upon would have been required, concluding that the inquiries made by Mr. Wall were not sufficient to satisfy the requirements under AU543.10.
- [64] The Discipline Committee found that, even if the use of the SEC 17a-5 Reports was not restricted, "(n)o reliance could be placed on the 17a-5 Report certified by BLMIS's auditors, Friebling & Horowitz, as PwC did not obtain any evidence of reliability of the tests performed and the results thereof as required by AU543.12" ([DC Decision, para. 129](#)). This is supported by Dr. Holstrum's evidence as found in his report and as stated in the Discipline Committee's decision at paragraph 60(b):

In my opinion, Mr. Wall failed to comply with GAAS requirements relating to using and relying on the work of other auditors, which are described in AU 543. In my opinion, Mr. Wall failed to make sufficient appropriate inquiries concerning the professional reputation, competence, capabilities, and independence of the other auditor and failed to perform sufficient appropriate procedures required by GAAS for using or relying on the work of the other auditor, in accordance with AU 543). [US GAAS Appendix, Tab 5]

¹ Dan Lipton was the CFO of Fairfield Greenwich Group (FGG), a group of investment firms in New York which managed a number of funds, including Fairfield Sentry.

- [65] The Discipline Committee also found that as Mr. Wall made no reference in his audit report to the work of Mr. Friebling, Mr. Wall was required to perform the additional procedures pursuant to AU 543.12. Those procedures required the auditor to “obtain, and review and retain” specified information from the other auditor in order to rely on the SEC 17a-5 Reports certified by F&H. Mr. Wall argued that AU543.12 was only applicable if he was going to rely upon the financial statements of BLMIS. However, the expert witnesses, Mr. Devor and Dr. Holstrum testified that the standard did apply to the use of the SEC 17a-5 Report. The Discipline Committee found that there was no evidence that Mr. Wall visited with F&H or that he discussed or reviewed F&H's audit programs or audit documentation as required.
- [66] In summary, the Discipline Committee found that Mr. Wall did not satisfy the requirements of U.S. GAAS which would have been a pre-requisite to his ability to rely upon on the SEC 17a-5 Report. The evidence of Dr. Holstrum and that contained in Mr. Richter's report confirmed that, even if Mr. Wall could have relied on the SEC 17a-5 Reports for some other purpose, the reports did not provide sufficient evidence of the existence and effective operation of the relevant internal controls at BLMIS in its capacity as a service organization which formed part of the information systems of the audit client.
- [67] The Discipline Committee noted that the planning working papers only addressed the reliability of the SAS 70 Report prepared by Ernst & Young in relation to Citco Canada (“Citco”), a second service organization who provided administrative and custodial services to Fairfield Sentry. A SAS 70 is a report that describes the effectiveness and reliability of the system of internal controls of a service organization and is intended for the use of auditors of BLMIS' clients. No SAS 70 Report was provided by BLMIS ([DC Decision, para. 145](#)). Mr. Wall was familiar with the benefit of a SAS 70 Report as audit evidence of the operating effectiveness of the internal controls of a service organization given that he relied upon a SAS 70 Report for Citco as he planned the audit of Fairfield Sentry.
- [68] Dr. Holstrum and Mr. Devor maintained that a SEC 17a-5 Report is not the equivalent of a SAS 70 report and is not sufficient evidence of the operating effectiveness of the key internal controls.
- [69] In summary, because BLMIS is a service organization to Fairfield Sentry, BLMIS information systems are part of the information systems of Fairfield Sentry. The PwC audit team was required to test the existence and operating effectiveness of key internal controls, particularly segregation of the investment advisory function.
- [70] The SEC 17a-5 Report cannot be relied upon as evidence of the effective operation of the key internal controls at BLMIS for the following reasons:
- i. The SEC 17 a-5 Report does not specify which controls were tested and is not the equivalent of a SAS 70 Report which would identify the specific controls tested;
 - ii. PwC did not inquire into the professional reputation and independence of the audit firm that signed the SEC 17 a-5 Report nor did the audit team obtain,

review and retain required information from the files of the auditors of the SEC 17a-5 Report as required AU 543.12;

- iii. The last paragraph of the SEC 17a-5 Reports precluded the use of the reports by PwC.

- [71] The Appeal Committee finds that the reasons given by the Discipline Committee for its finding that Mr. Wall had failed to obtain sufficient audit evidence of the operating effectiveness of the key internal controls at BLMIS are clear and cogent, having considered not only the evidence of Mr. Wall but that of other witnesses. The Appeal Committee finds that it was entirely reasonable for the Discipline Committee to conclude that Mr. Wall should not have relied upon the SEC 17a-5 Reports as providing sufficient appropriate audit evidence of the effectiveness of BLMIS' internal controls either in the planning or the execution of the audit. Given that PwC could not rely upon the SEC 17a-5 Report, PwC had no audit evidence of the effective operation of the key internal controls at BLMIS. PwC failed to gather sufficient appropriate audit evidence of the effective operation of the internal controls at BLMIS.
- [72] The Appeal Committee also considered Mr. Wall's position on appeal that by the very nature and content of the underlying audit work required to prepare a SEC 17a-5 Report, the auditor would have been required to test the specific internal controls that Mr. Wall intended to rely upon. However, given that Mr. Wall presented no evidence to support this position and the expert testimony in fact contradicted this position, the Appeal Committee did not accept this argument.
- [73] The Appeal Committee finds that the ultimate determination of the Discipline Committee with regard to the insufficiency of audit evidence to support the audit reports for the years in question was reasonable in light of the evidence presented at the hearing and the totality of the evidence considered by the Discipline Committee as set out in its reasons.

iii. Failure to Properly Consider Evidence Relating to Audit Risk, Income Statement & Balance Sheet

- [74] Having identified the various functions BLMIS performed for Fairfield Sentry, the Discipline Committee concluded Mr. Wall should have recognized that BLMIS was part of the information system of Fairfield Sentry and he failed to plan an appropriate audit response given the circumstances identified by Mr. Wall and his audit team.
- [75] Given Mr. Wall's failure to obtain sufficient appropriate audit evidence of the operating effectiveness of the key internal controls at BLMIS, including segregation of duties, the Discipline Committee found that Mr. Wall could not rely on audit confirmations from BLMIS as evidence of the existence of assets and the occurrence of the related income as the confirmations were not from an independent source. The Discipline Committee considered Mr. Wall's transaction testing, acknowledging that some information "such as the price of shares sold could be obtained from sources other than BLMIS. But the evidence of the occurrence of the trades and the existence of the assets which Fairfield Sentry, FGG and Citco Canada had all came (sic) from BLMIS" ([DC Decision, para.133](#)). Mr. Wall had no other appropriate audit evidence that he could rely on regarding the

existence of the assets held by BLMIS for Fairfield Sentry or the occurrence of income reported on those assets ([DC Decision, para. 136](#)).

- [76] At the disciplinary hearing, Mr. Wall asserted that the memorandum reporting on the site visit to BLMIS by personnel from the PwC Bermuda office provided him with the understanding of the internal controls at BLMIS, and the SEC 17a-5 Reports provided evidentiary matter of the effective operation of those controls at BLMIS. Based on these assertions, Mr. Wall concluded that he could accept the confirmations provided by BLMIS. The Discipline Committee did not accept Mr. Wall's assertions.
- [77] In his appeal, Mr. Wall argued that the Discipline Committee failed to appropriately consider the audit evidence described above. Moreover, he argued that he did not need to rely upon the testing of internal controls to modify the timing, nature or extent of PwC's substantive testing of the existence of Fairfield Sentry's assets. Instead, he argued that he intended to rely upon BLMIS's confirmations of 100 percent of Fairfield Sentry's assets held by BLMIS.
- [78] As stated earlier in these reasons, the Discipline Committee concluded that Mr. Wall did not have any evidence that the internal controls of BLMIS were operating effectively, and that such evidence was essential before Mr. Wall could rely on the confirmations received from BLMIS. The Discipline Committee stated that "any confirmations from BLMIS were not from an independent third-party which PwC called for in their planning" ([DC Decision, para. 136](#)).
- [79] The Appeal Committee finds that the conclusions reached by the Discipline Committee were clearly articulated and reasonable. The Discipline Committee's reasons were based on the experts' evidence that Mr. Wall could not rely on the SEC 17a-5 Reports as evidence of the effective operation of the internal controls at BLMIS. Without this evidence or any other appropriate audit evidence, Mr. Wall should not have relied upon the confirmations from BLMIS as they were not from an independent source. As well, Mr. Wall did not have any other appropriate audit evidence that he could rely on concerning the existence of the assets or the occurrence of revenues reported on Fairfield Sentry's financial statements.

iv. Failure to Properly Consider the Increased Audit Risk as a Result of 95% of the Assets Being Held by BLMIS

- [80] One of the particulars considered by the Discipline Committee was whether in the planning and execution of the audits for both 2006 and 2007, Mr. Wall had appropriately considered and audited the increased risk of material misstatement of the financial statements given that approximately 95% of the net assets of Fairfield Sentry were held by a third party "service organization". The Discipline Committee noted that this particular, as well as others, assumed or relied on a finding that Mr. Wall had failed to obtain the appropriate audit evidence with respect to BLMIS ([DC Decision, para.19](#)).
- [81] As detailed above, the Discipline Committee provided reasons and the conclusion that Mr. Wall did not have sufficient and appropriate audit evidence to accept the confirmations made by BLMIS about the value of the net assets it held for Fairfield Sentry or the net income it earned for Fairfield Sentry. The Discipline Committee

considered the expert testimony of Dr. Holstrum and Mr. Devor who both identified the fundamentally important underlying reality of the audit, that without the assets said to be in the custody of BLMIS and without the income purportedly earned from transactions conducted by BLMIS, Fairfield Sentry had virtually nothing.

- [82] The Discipline Committee summarizes the audit failures and concludes that in accepting confirmations from BLMIS, and accepting the 17a-5 Reports as sufficient evidential matter in a GAAS audit of financial statements, and in failing to inquire about the professional qualifications and independence of F&H, Mr. Wall failed to appropriately consider and audit the increased risk of material misstatement of the financial statements due to over 95% of the net assets of the company being held by a third party service organization that provided not only the investment management/advisory function but also the prime broker-dealer and custodial functions for these assets. The Discipline Committee noted “that Mr. Wall and the PwC audit team should have realized that while BLMIS was not their client, it was not just part of its client’s information system, it was the vital part of their client’s information system” ([DC Decision, para.124](#)).
- [83] Mr. Wall maintained that he used copies of the SEC 17a-5 Reports and the Statement of Financial Condition reports as evidence of the operating effectiveness of the key internal controls with respect to segregation of duties at BLMIS. It therefore followed that the confirmations provided by BLMIS were sufficient and appropriate audit evidence of the existence and value of the net assets BLMIS held for Fairfield Sentry and the net income it earned for Fairfield Sentry.
- [84] Having reviewed the audit planning and other audit evidence, and considered the significance of any potential misstatement of the financial statements relating to the assets held by BLMIS, the Discipline Committee found that Mr. Wall failed to consider and provide an appropriate audit response to the increased risk of material misstatement of the financial statements due to approximately 95% of the net assets of Fairfield Sentry being held by a third party “service organization” (BLMIS).
- [85] The Appeal Committee finds that it is clear from the Discipline Committee’s Decision that it considered the explanation offered by Mr. Wall regarding his use of the confirmations, as well as all the evidence relating to the audit. The Discipline Committee’s finding that Mr. Wall failed to appropriately consider and audit the increased risk of material misstatement of the financial statements due to the majority of the net assets of Fairfield Sentry being held by BLMIS was reasonable and justified in its reasons. There was nothing in the audit planning documenting that the audit team was aware of or that it considered this increased risk of having such a significant portion of the assets managed by a service organization.

B. Failure to Properly Exercise Professional Skepticism Pursuant to U.S. GAAS (Ground v)

- [86] The Discipline Committee found that Mr. Wall did not exercise the professional skepticism required by U.S. GAAS during the audit process.

- [87] In his appeal, Mr. Wall took the position that he “did not fail to exercise appropriate professional skepticism or adequately consider and address the audit risk with respect to the audit evidence he obtained from and with regard to the services BLMIS provided to the Fund and the information BLMIS provided to PwC via the confirmation process” (Appellant’s factum, para. 673). Mr. Wall argued that his inquiries of Mr. Lipton were adequate given Mr. Lipton’s past experience as an independent auditor of funds; Fairfield Greenwich Group’s related due diligence conducted on its service providers and their auditors; as well as the SEC requirements of broker-dealer auditors, and, F&H’s significant history in filing reports with the SEC. Mr. Wall argued that U.S. GAAS allows an auditor to rely upon inquiries of third parties, as Mr. Wall did when he relied upon Mr. Lipton with respect to the professional reputation and standing of F&H.
- [88] In considering whether Mr. Wall exercised sufficient professional skepticism during the audit process, the Discipline Committee concluded that Mr. Wall did not meet the standards of practice required by U.S. GAAS when he accepted the SEC 17a-5 Report. The Discipline Committee found that it was insufficient for Mr. Wall to simply rely upon the general enquiries made of Mr. Lipton regarding the professional qualifications and independence of F&H. Mr. Wall was required to assess F&H’s independence from BLMIS and the adequacy and appropriateness of F&H’s procedures, by following the requirements of AU 543.10 and AU 543.12. Significantly greater enquiry and procedures than undertaken by Mr. Wall were required to meet the standards required by U.S. GAAS ([DC Decision, paras. 129 and 137](#)).
- [89] A-22 to A-26 of section 200 of AU-C of the U.S. GAAS require an auditor to plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause financial statements to be materially misstated.
- [90] The Discipline Committee clearly set out the evidence in support of its conclusion that Mr. Wall failed to exercise sufficient and appropriate professional skepticism in the following areas:
- i. by not identifying BLMIS as a service organization in the audit planning stage;
 - ii. by accepting the SEC 17a-5 Reports as sufficient and appropriate audit evidence of the effective operation of the internal controls and the segregation of departments at BLMIS;
 - iii. by accepting confirmations not provided by an independent party;
 - iv. by relying upon the report of F&H without adequately enquiring into their professional qualifications, independence and the appropriateness and sufficiency of the testing by F&H to support their SEC 17a-5 Reports; and
 - v. by failing to appropriately consider and audit the increased risk of material misstatement of the financial statements due to 95% of the net assets of the company being held by a third-party service organization.
- [91] The definition of professional skepticism according to AU-C section 200.14 of U.S. GAAS is as follows: an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

- [92] The Appeal Committee finds that the Discipline Committee's conclusion that Mr. Wall failed to exercise appropriate professional skepticism was reasonable based on the evidence before it. Mr. Wall failed to consider the conditions that existed, in particular, that BLMIS controlled 95% of the net assets of Fairfield Sentry. Given that Mr. Wall identified the services provided by BLMIS to Fairfield Sentry as meeting the definition of "service organization", he should have altered his audit response. The Discipline Committee found that Mr. Wall relied solely on his conversations with Mr. Lipton, who was the CFO of FGG. Mr. Wall acknowledged that he did not enquire into the specific due diligence undertaken by Mr. Lipton to satisfy himself with respect to the independence, professional standing and quality of work done by F&H. He made no other inquiries of other sources relating to F&H. As the Discipline Committee observed, audit standards required Mr. Wall to take further steps to confirm the independence of the auditor and assess the reliability of the information provided to him.

C. Failure to Consider Evidence of Common Practice (Ground iii)

- [93] On appeal, Mr. Wall argued that the Discipline Committee failed to properly consider the evidence of common practice of other similarly situated audit professionals with respect to the audit considerations and procedures required by U.S. GAAS. Specifically, the Discipline Committee failed to consider that no other similarly situated fund auditor performed either additional or different audit procedures with respect to BLMIS than those performed by Mr. Wall. In other words, Mr. Wall acted consistently with common practice.
- [94] In support of this argument, Mr. Wall relied upon Mr. DeAngelis' opinion "that it is relevant 'to consider that other auditors, who supposedly conducted audits in accordance with the professional standards both during and before this relevant time period ... issued unqualified opinions' " ([DC Decision, para. 166](#)). The Discipline Committee found several difficulties with this opinion, noting that Mr. DeAngelis had seen no working papers of other auditors and no other auditor who had done what Mr. Wall did was called as a witness. The Discipline Committee concluded that, "even if every other auditor of a fund did as Mr. Wall did, this would not change the fact that no reasonable auditor who followed the requirements of U.S. GAAS would have done so" ([DC Decision, para. 166](#)).
- [95] There was no evidence before the Discipline Committee that established that other audit professionals conducting an audit of a hedge fund under U.S. GAAS in substantially identical circumstances would have failed to consider as a key issue whether they were dealing with a service organization. There was no evidence that other audit professionals in similar circumstances would have failed to document this analysis in the audit Working Papers or that they would have relied on the SEC 17a-5 Reports as sufficient appropriate audit evidence of the effectiveness of the relevant internal controls ([DC Decision, para. 164](#)).
- [96] The Discipline Committee was provided with decisions from other jurisdictions which related to the prosecutions of other auditors. In addition, the Discipline Committee reviewed standard cases from other professions, as well as cases which involved the Madoff fraud. In its review of the case law relating to standards of other professions, the

Discipline Committee distinguished those cases noting that in the case before them, the required conduct was codified. The Committee also noted that the facts and/or standards before other bodies relating to cases pertaining to the Madoff fraud differed from those before the Discipline Committee.

- [97] The Discipline Committee declined to accept the cases presented by Mr. Wall as proof that Mr. Wall had acted in accordance with common practice of fund auditors in this situation. They noted that the other auditors were either not subject to the U.S. GAAS standards or the arbitration and court decisions relied upon by Mr. Wall did not address the issues that were before the Discipline Committee.
- [98] During the course of the Appeal Committee's deliberations, Mr. Wall provided the Appeal Committee with the decision of *Krys et al v. PricewaterhouseCoopers Accountants N.V. et al*, supra. The PCC did not object to the filing of this case, and provided a brief summary of its position as to the relevance of the decision.
- [99] In *Krys*, the District Court of Amsterdam noted that the acquittal of Mr. Krys in those proceedings was not "incompatible" with the Discipline Committee findings against Mr. Wall, given that the Discipline Committee was dealing with a number of distinguishing facts, including different auditing standards. (*Krys*, p.3.27)
- [100] In his appeal, Mr. Wall argued that if "a responsible and competent body of professional opinion supports the professional's conduct or judgment" professional misconduct cannot be found (Appellant's factum, para. 592). In support of this argument, Mr. Wall relied upon the decision in *Knippel v. Institute of Chartered Accountants of Saskatchewan*, 1991 CarswellSask 627, which relates to an audit of an entity within a regulated industry for the proposition that where an auditor's work was consistent with common practice of auditors or entities in a specific industry, a finding of professional misconduct should not be made. In the *Knippel* case, evidence was provided as to the practice of other audit firms in similar situations.
- [101] Mr. Wall provided no evidence of what other auditors did in circumstances similar to the audit of Fairfield Sentry. There was no evidence presented to the Discipline Committee that showed that Mr. Wall's conduct was consistent with acceptable common practice. In the absence of such evidence, his argument that on the basis of common practice professional misconduct could not be found was unsupported.
- [102] The Appeal Committee found that the Discipline Committee's rejection of the argument that Mr. Wall acted consistently with common practice was reasonable.

D. Failure to Consider the Alleged Inexperience and Bias of the PCC's Investigator and a Failure to Properly Consider the Evidence of Witnesses Called (Grounds i and iv)

- [103] In his appeal, Mr. Wall maintained that the Discipline Committee's Reasons do not adequately address the credibility findings made in the course of its consideration of the evidence and that it failed to clearly and intelligibly explain its preferring of certain witness evidence over that of other witnesses.

- [104] In the Discipline Committee's decision, the Discipline Committee set out the unchallenged criteria that should be applied when weighing the expert evidence before it. The criteria identified by the Discipline Committee included: the relevance of the expert's qualifications; the impartiality of the expert and whether the expert's testimony appeared credible and persuasive when compared to the testimony of the other experts; and the internal and external consistency of the expert's testimony including his or her report. The Discipline Committee specifically referred to Mr. Wall's counsel's submission that "motivation" should be included as an additional factor to be considered in assessing credibility ([DC Decision, para. 105 and 106](#)).
- [105] The Discipline Committee went on to apply these criteria to its analysis of the expert witnesses called by the parties.
- [106] The Discipline Committee also noted in its decision that the parties had taken the opportunity to vigorously challenge the credibility, experience and motivation of each other's experts.
- [107] Given that the Discipline Committee heard the testimony and applied the relevant and unchallenged criteria, there is no basis on which to interfere with the Discipline Committee's findings as to credibility.

i. Mr. Devor's Credibility and Alleged Inadequacies of His Investigation

- [108] Mr. Devor was called as a witness by the PCC. He provided evidence both in relation to his investigation and as an expert on U.S. standards of practice and U.S. GAAS. Mr. Wall challenged Mr. Devor's testimony claiming that as the investigator for the PCC, he held an inherent bias.
- [109] On appeal, Mr. Wall argued that the Discipline Committee erred in accepting Mr. Devor's evidence regarding Mr. Wall's use of the SEC 17a-5 Report. Mr. Wall maintained that Mr. Devor's investigation was substantively deficient, that he lacked sufficient audit experience (including reporting and auditing requirements applicable to U.S. SEC-registered broker-dealers) and that he was biased and engaged in improper advocacy on behalf of the PCC.
- [110] In support of this argument, Mr. Wall pointed to his own lack of access to Mr. Devor's report during the investigative stage; Mr. Devor's failure to investigate the general practices of fund auditors with respect to these issues, and his failure to consider inadequacies within the investigation itself. Each of these criticisms was raised by Mr. Wall and his counsel during the disciplinary hearing, and each of these criticisms was thoroughly addressed in the Discipline Committee's decision.
- [111] The PCC called Mr. Devor to also provide opinion evidence as an expert witness. Counsel for Mr. Wall chose not to challenge Mr. Devor's qualification as an expert on U.S. standards of practice and U.S. GAAS, subject to the right to cross-examine Mr. Devor with a view to limiting the weight the Discipline Committee would give to his testimony.

- [112] On appeal, Mr. Wall challenged the Discipline Committee's reasons, arguing that the Discipline Committee failed to properly consider the qualifications and experience of Mr. Devor, arguing that Mr. Devor did not have the "special skill or knowledge" required under U.S. GAAS to provide an expert opinion. Mr. Wall also argued that Mr. Devor's opinion was biased given his role as both investigator and expert called by the PCC.
- [113] The PCC argued that the Appeal Committee was foreclosed from considering this argument, as any objection to Mr. Devor's qualification as a witness should have been raised during the disciplinary hearing.
- [114] The Appeal Committee agrees with the position of the PCC. It was not open to Mr. Wall to challenge Mr. Devor's qualifications as an expert given the position taken by Mr. Wall at the discipline hearing.
- [115] Based on the unchallenged qualifications of Mr. Devor, the Discipline Committee went on to assess his evidence and opinion.
- [116] In its reasons as noted, the Discipline Committee noted the criteria it was to apply in its assessment of the witness's evidence before it. The Discipline Committee had the advantage of hearing Mr. Devor's testimony over the course of a total of 11 days and his cross examination over the course of 6 days. The Discipline Committee also assessed Mr. Devor's evidence in light of all the evidence presented by the parties. The reasons given by the Discipline Committee specifically address Mr. Wall's primary criticism of Mr. Devor's interview of the audit team regarding their intended use of, or reliance on, the SEC 17a-5 Reports. The Discipline Committee found that the testimony of the audit team members with respect to the intended use of the SEC 17a-5 Reports was inconsistent with their working papers and the other information the audit team provided in their interviews with Mr. Devor.
- [117] Based on the reasons given and the totality of the evidence before the Discipline Committee, the Appeal Committee sees no reason to interfere with the Discipline Committee's findings of credibility with respect to Mr. Devor.

ii. Evidence of Other Witnesses Called During the Hearing

- [118] Mr. Wall was critical of the manner in which the Discipline Committee considered the evidence of Dr. Holstrum, in particular criticizing the sufficiency of the reasons with regard to alleged differences between Mr. Holstrum's evidence and that of Mr. Devor.
- [119] Mr. Wall did not object to Dr. Holstrom being qualified as an expert during the hearing. In its reasons, the Discipline Committee reviewed his detailed knowledge of the relevant audit standards.
- [120] The Discipline Committee had set out the evidence of Mr. Devor, as well as that of Dr. Holstrum and the other witnesses, before engaging in their analysis. The Discipline Committee specifically focused on the evidence relating to what it identified as the essential issue in the case, namely that the PwC team could not use or rely on the SEC 17a-5 Reports as evidence of the operating effectiveness of the key internal controls at BLMIS.

- [121] The Discipline Committee found Mr. Devor and Dr. Holstrum agreed on a number of essential facts and specifically, that BLMIS was a service organization to Fairfield Sentry. As such, they agreed that BLMIS was a part of the information system of Fairfield Sentry. They further agreed that Mr. Wall was required to obtain sufficient appropriate audit evidence of the operating effectiveness of internal controls at BLMIS. Both Mr. Devor and Dr. Holstrum were of the opinion that Mr. Wall could not rely on the SEC 17a-5 Reports as audit evidence of the operating effectiveness of the internal controls at BLMIS and, consequently, Mr. Wall failed to obtain the required audit evidence of the effective operation of the internal controls at BLMIS. The two witnesses also agreed that in the alternative, had Mr. Wall been able to rely upon the SEC 17a-5 Reports, he nonetheless failed to make sufficient enquiries into the reputation, standing and independence of F&H. Mr. Wall failed to obtain evidence of the reliability of the tests performed and the results thereof by F&H which was a pre-requisite to relying upon SEC 17a-5 Reports prepared by F&H. Mr. Wall could not rely on the confirmations from BLMIS with respect to the assets it held on behalf of Fairfield Sentry. The Discipline Committee found that Mr. Devor and Dr. Holstrum ultimately agreed that Mr. Wall had not complied with the requirements of U.S. GAAS.
- [122] On appeal, Mr. Wall argued that the Discipline Committee rejected the evidence of Mr. DeAngelis, an expert witness on behalf of Mr. Wall, without considering his testimony in its entirety.
- [123] The Discipline Committee considered Mr. DeAngelis' opinion on the fundamental issue as to whether BLMIS was a service organization. At paragraphs 114 to 117 of the Discipline Committee's reasons, the Committee set out in detail the basis of Mr. DeAngelis' opinion as to why he had concluded that BLMIS was not a service organization. The Discipline Committee rejected Mr. DeAngelis' opinion, finding that he ignored pertinent facts in arriving at his conclusion regarding the characterization of BLMIS' role in relation to investing the funds of Fairfield Sentry. The Discipline Committee also noted that Mr. DeAngelis was the only expert witness to take the position that BLMIS was not a service organization. Even Mr. Wall and his audit team conceded that BLMIS was a service organization.
- [124] Despite having concluded that BLMIS was not a service organization, Mr. DeAngelis went on to opine that the SEC 17a-5 Reports could provide adequate evidence regarding the existence and effectiveness of the internal controls at BLMIS.
- [125] In spite of the limitation and prohibition found in the last paragraph of the SEC 17a-5 Reports, Mr. DeAngelis opined that any party who had been provided a copy of the reports by BLMIS' management, was entitled to rely upon the SEC 17a-5 Reports.
- [126] Mr. DeAngelis took the position that once management had been provided with the SEC 17a-5 Reports, management was entitled to use the reports, notwithstanding the prohibition found in the SEC 17a-5 Reports. The Discipline Committee found that this reasoning made "nonsense of the prohibition" found in the reports. The Discipline Committee went on to conclude that "the 17a-5 report can only be used to demonstrate regulatory compliance." It found that the report "is not evidence in a GAAS audit of financial statements" ([DC decision, para. 120](#)).

- [127] On appeal, Mr. Wall argued that the Discipline Committee did not address three “reasonable approaches” that Mr. DeAngelis suggested could have been adopted by Mr. Wall. The three options are dependent on the following two propositions: that BLMIS was not a service organization to Fairfield Sentry, and that the SEC 17a-5 Reports could be relied upon as evidence of the operating effectiveness of the internal controls at BLMIS. The Discipline Committee did consider these two propositions in paragraphs 114 to 121 of its reasons. The Discipline Committee found that BLMIS was a service organization and that the SEC 17a-5 Reports could not be relied upon as evidence of the operating effectiveness of the internal controls at BLMIS. Having arrived at these conclusions, the Discipline Committee did not need to further deal with the three approaches suggested by Mr. DeAngelis which were based on a different set of premises.
- [128] The Appeal Committee found that on the question of whether BLMIS was a service organization, it was entirely reasonable for the Discipline Committee to accept the evidence of the experts other than Mr. DeAngelis, and that of Mr. Wall, who himself also agreed that BLMIS was a service organization. Mr. DeAngelis’ opinion that BLMIS was not a service organization, a crucial issue, stood alone and was not supported by the other expert witnesses, nor by the PwC’s own audit team. The Appeal Committee found the Discipline Committee duly considered Mr. DeAngelis’ evidence, including alternative approaches that in his opinion could have been taken by Mr. Wall. The Appeal Committee found the Discipline Committee considered Mr. DeAngelis’ evidence, and that its decision not to rely on the evidence of Mr. DeAngelis was reasonable.
- [129] The Appeal Committee finds that the Discipline Committee’s decision clearly sets out its considerations as to the credibility of the witnesses called, as well as of the expert opinions proffered by the parties. As noted earlier, given that the Discipline Committee heard the testimony of the witnesses, clearly applying the requisite criteria for assessing the evidence before, the Appeal Committee finds no basis to interfere with the Discipline Committee’s findings on credibility.

E. Allegations of Misinterpretation and Misapplication of U.S. GAAS Provisions by the Discipline Committee and Findings of Professional Misconduct as Opposed to a Failure to Exercise Professional Judgment (Grounds v and vi)

- [130] On appeal, Mr. Wall argued the Discipline Committee misinterpreted and misapplied the provisions of U.S. GAAS so as to impose upon Mr. Wall requirements not found therein, which it would have been impossible for him or any other auditor to comply with.
- [131] Having heard extensive evidence on standards of practice, the Discipline Committee relied upon the testimony of experts in the application of the requirements pursuant to U.S. GAAS in these particular audit circumstances. These same standards apply to any audit firm planning and conducting an audit in similar circumstances.
- [132] The Appeal Committee is not persuaded that the Discipline Committee misinterpreted or misapplied the provisions of U.S. GAAS nor that those provisions imposed standards that could not be complied with.

- [133] The Discipline Committee found the cumulative effect of the audit omissions and the conduct of Mr. Wall (as detailed earlier) was significant in light of U.S. GAAS. In addressing Mr. Wall's submissions that Mr. Wall's conduct amounted to an error in judgment, but did not amount to professional misconduct, the Discipline Committee, after having reviewed the law relating to what amounts to professional misconduct stated:

Given this statement of the law and the nature and impact of Mr. Wall's failures, there is no question that the proven Allegations constitute professional misconduct. It is difficult to exaggerate how significant the failures to adhere to the standards (the misconduct) were to the audits. The member accepted representations from BLMIS without any evidence that the information provided by BLMIS was reliable. Basically, all Fairfield Sentry had was what BLMIS said it had. There was no basis for saying the financial statements represented fairly the assets and income of Fairfield Sentry. The member could not and did not suggest the amounts were not material, the assets were misstated by billions of dollars and the income was misstated by hundreds of millions of dollars.

(DC Decision, para. 165)

- [134] The Appeal Committee finds that the Discipline Committee carefully considered what constitutes professional misconduct in its Reasons. The Discipline Committee clearly articulated the audit failures by Mr. Wall and addressed both how and why those audit failures rose to the level of professional misconduct. The Discipline Committee did not hold Mr. Wall to a higher standard, but rather to the same standard as any auditor would be held to in similar circumstances. The Appeal Committee finds the Discipline Committee's finding that Mr. Wall's conduct rose to the level of professional misconduct and was not a mere error in judgment to be based reasons which are justified, transparent and intelligible, and also falls within a range of reasonable outcomes in respect of the facts and the law.

VIII. CONCLUSION

- [135] At the core of the Discipline Committee's decision is the conclusion that when conducting the audit of Fairfield Sentry, the relevant professional standards are such that, accepting that Mr. Wall acknowledged BLMIS as a service organization, he should have treated its systems as an integral part of the information systems of Fairfield Sentry. Accordingly, Mr. Wall was required under U.S. GAAS to design and execute the audit on that basis. As such, the Discipline Committee found that it was not sufficient for Mr. Wall to rely on confirmations provided by BLMIS without also obtaining the necessary understanding of the internal controls at BLMIS and sufficient appropriate audit evidence as to their effectiveness. The Discipline Committee concluded that Mr. Wall did not document his assessment of BLMIS' status as a service organization, he did not document the related audit implications and he failed to obtain and document sufficient appropriate audit evidence of the testing of the effectiveness of BLMIS' internal controls.
- [136] Having considered the various grounds of appeal raised by Mr. Wall, having heard and considered the submissions made on behalf of Mr. Wall and on behalf of the

Professional Conduct Committee, upon reviewing the materials filed by the parties, and after careful deliberation, this Panel found the decision of the Discipline Committee provided reasons that contained justification, transparency and intelligibility leading to its conclusions and as a result dismissed the appeal.

IX. ORDER FOR SUBMISSIONS ON COSTS

- [137] The Professional Conduct Committee is directed to make any submissions on costs in writing within 10 days of the date of this Decision and Order, not exceeding five pages excluding the costs outline. The Member may make responding submissions with respect to costs in writing within 10 days of the receipt of the submissions of the Professional Conduct Committee, also not to exceed five pages, excluding a costs outline, if any. The Professional Conduct Committee may make reply submissions within 5 days after receiving the Member's submissions, not to exceed two pages.

DATED at Toronto this 19th day of July, 2019



Laurence Bookman, CPA, CA
Appeal Committee – Chair

Members of the Panel

Paul Busch, CPA, CA
Don Dafoe, FCPA, FCA
Daniel Iggers (Public Representative)
Virendra Sahni (Public Representative)

Independent Legal Counsel

Nadia Liva, Barrister & Solicitor

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO ACT, 2017

APPEAL COMMITTEE

IN THE MATTER OF: An appeal by **STEPHEN W.A. WALL, CPA, CA** of the Decision of the Discipline Committee, made March 20, 2017, and Order, made October 6, 2017, under Rule 24 of the Rules of Practice and Procedure.

BETWEEN:

Stephen W. A. Wall

-and-

**Chartered Professional Accountants of Ontario
Professional Conduct Committee**

Written Submissions:

For Mr. Wall:	Cynthia Amsterdam, Counsel Timothy A. Duffy, Counsel Emily Nicklin, Counsel
For the Professional Conduct Committee:	Paul F. Farley, Counsel Brian Bellmore, Counsel
Heard:	September 12, 2019
Decision and Order effective:	September 16, 2019
Release of written reasons:	September 16, 2019

REASONS FOR COSTS ORDER MADE SEPTEMBER 12, 2019

I. WRITTEN SUBMISSIONS ON COSTS

1. Stephen W.A. Wall appealed the Decision of the Discipline Committee of Chartered Professional Accountants of Ontario ("Discipline Committee") dated March 20, 2017 and the Final Order dated October 6, 2017. The Appeal of the Discipline Committee was heard over 4 ½ days in August and October of 2018. On July 19, 2019, this Appeal Committee dismissed Mr. Wall's appeal.

2. Following the dismissal of the appeal, the Professional Conduct Committee (“PCC”) sought costs against Mr. Wall on a full indemnity basis in the amount of \$233,731.05. Mr. Wall does not dispute the Appeal Committee’s jurisdiction to award costs, nor does he argue that no costs should be awarded against him. Rather, Mr. Wall invited the Appeal Committee to award costs on a partial indemnity basis, in the range of \$156,000 to \$175,000.
3. Pursuant to Section 38(2) of the *Chartered Professional Accountants of Ontario Act, 2017* and Rule 20.01 of CPA Ontario’s *Rules of Practice and Procedure*, the Appeal Committee has the discretion to award costs of the appeal proceeding against Mr. Wall following the dismissal of his appeal.
4. Section 28 of *Regulation 6-3 Appeals Committee* provides that where an Appeal Committee chooses to exercise its discretion, it may order full or partial payment of costs, and may also order sanctions for non-compliance.
5. Having decided to exercise its discretion to award costs to the PCC following the dismissal of Mr. Wall’s appeal, this Committee considered the written submissions submitted by the parties on the issue of whether costs should be awarded on a full or partial indemnity basis. The Committee was provided with a Costs Outline submitted by the PCC in support of its position, and books of authorities from both parties.
6. The issues determined by the Discipline Committee, and in turn, considered by the Appeal Committee, were important to the profession and were of significant complexity. The PCC does not suggest that Mr. Wall’s appeal was without merit, vexatious, or brought in bad faith. The Discipline Committee decision and the decision of this committee will have a significant impact on Mr. Wall’s professional career. Mr. Wall has every right to pursue a vigorous appeal of the Discipline Committee’s decision, which included challenging the constitution of the Appeal Committee and raising concerns regarding potential bias on the part of the committee members. This committee does not find the motions seeking to recuse this committee as being brought in bad faith.
7. While the Appeal Committee found that the presentation of Mr. Wall’s appeal was at times unfocused, the manner in which the Appellant chose to present his position did not hamper the Appeal Committee’s ability to comprehend his arguments.
8. Substantial and full indemnity awards are reserved for rare and exceptional cases. The Appeal Committee does not find Mr. Wall’s appeal to be a “rare or exceptional case” worthy of full indemnity.
9. Mr. Wall does not take issue with the costs set out in the PCC’s Cost Outline.
10. After considering all the circumstances of this case, including the reasonable expectation of Mr. Wall regarding the amount of costs he might be expected to pay in the event his appeal was dismissed, the Appeal Committee awards costs to the PCC for this appeal

on a partial indemnity basis in the amount of \$175,000, payable to CPA Ontario within 30 days of this decision.

DATED at Toronto this 16th day of September, 2019



Laurence Bookman, CPA, CA
Appeal Committee – Chair

Members of the Panel

Paul Busch, CPA, CA
Don Dafoe, FCPA, FCA
Daniel Iggers (Public Representative)
Virendra Sahni (Public Representative)

Independent Legal Counsel

Nadia Liva, Barrister & Solicitor