CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
(THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO)
THE CHARTERED ACCOUNTANTS ACT, 2010

DISCIPLINE COMMITTEE

IN THE MATTER OF: Allegations against **STEPHEN W.A. WALL**, **CPA, CA**, a Member, under **Rule 206.1** of the Rules of Professional Conduct, as amended.

TO: Mr. Stephen W. A. Wall, CPA, CA

AND TO: The Professional Conduct Committee

DECISION AND REASONS OF THE DISCIPLINE COMMITTEE

Introduction

1. This tribunal (a panel of the Discipline Committee of the Chartered Professional Accountants of Ontario, hereinafter referred to as the "panel") convened on September 15, 2014, to hear the Allegations of professional misconduct made by the Professional Conduct Committee of the Chartered Professional Accountants of Ontario ("CPA Ontario") against Stephen A. W. Wall, CPA, CA, ("Mr. Wall"). There were a number of motions heard prior to the start of the hearing.

2. Following the introduction of the counsel and attendees on September 15, 2014, Mr. Wall entered a plea of not guilty to the two Allegations. Thereafter the panel heard evidence and motions for a total of 43 days. As will be clear from the Schedule of Proceedings, which is attached to these reasons, the evidence concluded in July of 2015 and oral submissions were heard in December 2015. Prior to the oral submissions the parties filed voluminous written submissions.

3. The panel said at the conclusion of the submissions that our decision would be made known at the time we released our reasons. These are the reasons for our decision. The reasons include a summary of the proceedings, an outline of the evidence and the positions of the parties (the PCC and Mr. Wall) on the matters which are relevant. Our primary concern is to be clear on the basis for our decision, i.e. based on evidence we found to be clear, cogent and convincing, our findings on the relatively few facts in dispute and the requirements of the applicable standards.

4. The ultimate determination the panel had to make was whether or not Mr. Wall complied with the applicable auditing standards when he accepted the information (confirmations) provided by Bernard L. Madoff Securities Limited, LLC ("BLMIS") about the assets of and income for Fairfield Sentry Limited ("Fairfield Sentry") for the years ended

December 31, 2006, and December 31, 2007. The panel concluded that he failed to comply with the applicable auditing standards, i.e. United States Generally Accepted Auditing Standards (US GAAS) and as a result there was an audit failure. The panel concluded that the Allegations had been proven and Mr. Wall is guilty of professional misconduct.

Counsel and attendees

5. Mr. Paul Farley and Mr. Brian Bellmore appeared as counsel for the Professional Conduct Committee ("PCC"). They had with them Mr. Harris Devor, CPA (Pennsylvania), Ms. Karen Ho James CPA, CA, and Ms. Melissa Gentili, a lawyer. Also, from time to time, Ms. Samantha Wolfish, an articling student, assisted counsel for the PCC at the hearing.

6. Mr. Wall, sometimes referred to as "the member", was present throughout the hearing. He was represented by Ms. Emily Nicklin, Mr. Timothy Duffy and Ms. Cynthia Amsterdam. Mr. Robert Osborne, the general counsel of PricewaterhouseCoopers (PwC), Mr. Matthew Fleming, and Mr. Solomon Lam were present on September 15, 2014, and on many but not all of the subsequent days of the hearing. Ms. Amsterdam, Mr. Fleming and Mr. Lam (all of the law firm Dentons) are members of the Law Society of Upper Canada. Ms. Nicklin and Mr. Duffy, members of the law firm Kirkland & Ellis of Chicago, were registered students of the Law Society of Upper Canada and were sponsored by Ms. Amsterdam.

7. Mr. Harris Devor CPA (US) an investigator and expert called by the PCC, was present throughout the presentation of evidence. Dr. Gary Holstrum Ph.D., CPA (Florida), CFE, CFF, CIDA, an expert called by the PCC was present only for his evidence.

8. Mr. Tony DeAngelis CPA (US), an expert called by the member was present throughout the presentation of all of the evidence. Ms. Jennifer Hull, CPA (US), an expert called by the member, was also present throughout the presentation of the evidence until the conclusion of her evidence in June 2015. Ms. Patricia Perruzza, CA and Mr. Derek Hatoum, CA, both of PwC were also present on September 15, 2014, and on the days when they gave evidence. Mr. Michael Tambosso, FCPA, FCA, a former partner of PwC attended on many of the days of the hearing. Mr. Andrew Buchan, who supported electronic presentation of evidence was present throughout the hearing.

The relevant financial statements

9. On April 24, 2007, Mr. Wall authorized the release of the Report of the Independent Auditors to the Directors and Shareholders of Fairfield Sentry Limited ("Fairfield Sentry") a company incorporated under the laws of the British Virgin Islands. The Report included the unqualified audit opinion of PwC on the Financial Statements of Fairfield Sentry for the year ended December 31, 2006. The financial statements included on the balance sheet an item, "Financial assets at fair market value through profit or loss $5,555,567,000"; and stated on the income statement, "Net gains on financial assets and liabilities at fair value through profit or loss $549,938,000".

10. On April 7, 2008, Mr. Wall authorized the release of the Report of the Independent Auditors on the Financial Statements of Fairfield Sentry for the year ended December 31, 2007. The report included the unqualified audit opinion of PwC. The financial statements included on the balance sheet an item, "Financial assets at fair market value through profit or loss $7,173,165,000"; and stated on the income statement, "Net gains on financial assets and liabilities at fair value through profit or loss $624,752,000".

11. PwC's opinion dated April 24, 2007 for the year ended December 31, 2006 reads:

> **Report of Independent Auditors**
>
> **To the Directors and Shareholders of**
> **Fairfield Sentry Limited**
>
> In our opinion, the accompanying balance sheet and related income statement and the statements of changes in net assets attributable to holders of redeemable participating shares and cash flow present fairly, in all material respects, the financial position of Fairfield Sentry Limited (the "Company") as of December 31, 2006 and the results of its operations, the changes in its net assets attributable to holders of the redeemable participating shares and its cash flow for the year then ended in conformity with International Financial Reporting Standards. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these financial statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Company's management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
>
> PricewaterhouseCoopers LLP
> Chartered Accountants, Licensed Public Accountants

12. PwC's opinion for the year ended December 31, 2007 is identical to the opinion for the year 2006, except that it refers to the year ended December 31, 2007, not December 31,

2006, and is dated April 7, 2008, not April 24, 2007.

13. Both parties agree that the financial statements for each year are materially misstated and the opinion expressed each year, "that the accompanying balance sheet and related income statement and the statements of changes present fairly, in all material respects, the financial position of Fairfield Sentry" are wrong. Neither the PCC nor Mr. Wall suggested an actual value for the net assets or net income for either year.

14. Fairfield Sentry was ostensibly the largest of a number of funds managed by the Fairfield Greenwich Group ("FGG") a group of investment firms based in New York. Most of the money received from the shareholders of Fairfield Sentry was invested with BLMIS. Mr. Madoff later admitted that BLMIS had not purchased any securities with the funds provided from its various clients, including Fairfield Sentry, and that he had run one of the biggest Ponzi schemes in the history of North America. His Ponzi scheme is referred to in these reasons as the "Madoff fraud".

15. The Report of the Independent Auditors for each year was on the letterhead of the Toronto office of PwC. Mr. Wall, the partner of PwC responsible for the audit, was then a Chartered Accountant (CA) and a member of the Institute of Chartered Accountants of Ontario ("ICAO"), the governing body of Chartered Accountants in Ontario. Mr. Wall, now a Chartered Professional Accountant (CPA) (CA) is a member of the Chartered Professional Accountants of Ontario ("CPAO"), the governing body of CPAs and CAs in Ontario.

The Allegations

16. In June and October of 2009, two shareholders of Fairfield Sentry complained to the ICAO about the audits of Fairfield Sentry. After an investigation the PCC (of the ICAO) made two Allegations of professional misconduct against Mr. Wall in October 2012. These proceedings have been carried out pursuant to the provisions of the *Chartered Accountants Act, 2010* of Ontario and the bylaws and regulations passed thereunder, without any suggestion or complaint that the change in the name or composition of the organization to the Chartered Professional Accountants of Ontario changes or alters the jurisdiction of the Discipline Committee to hear the Allegations.

17. On the12th day of October, 2012, the PCC made the following Allegations.

> The Professional Conduct Committee of the Institute of Chartered Accountants of Ontario hereby makes the following allegations of professional misconduct against Stephen Wall, a member of the Institute:
>
> 1. THAT, the said Stephen Wall, in or about the period December 1, 2006 to April 30, 2007, while involved as the engagement partner with PricewaterhouseCoopers LLP in an engagement to audit the Financial

Statements of Fairfield Sentry Limited as at, and for, the year ended December 31, 2006, and having attached to the Financial Statements an unqualified audit opinion, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, contrary to Rule 206.1 of the Rules of Professional Conduct, in that:

(i) He failed to properly plan the audit;

(ii) He failed to identify the role of Bernard L. Madoff Investment Securities, LLC, 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) He failed to exercise sufficient and appropriate professional scepticism;

(iv) He 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) He failed to appropriately consider and audit the increased risk of material misstatement of the financial statements due to approximately $5.4 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) He failed to obtain sufficient and appropriate audit evidence of the operating effectiveness of the internal controls of Bernard L. Madoff Investment Securities, LLC, Fairfield Sentry's outside "service organization";

(vii) He 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";

(viii) He 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".

2. THAT, the said Stephen Wall, in or about the period October 1, 2007 to April 30, 2008, while involved as the engagement partner with

PricewaterhouseCoopers LLP in an engagement to audit the Financial Statements of Fairfield Sentry limited as at, and for, the year ended December 31, 2007, and having attached to the Financial Statements an unqualified audit opinion, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, contrary to Rule 206.1 of the Rules of Professional Conduct, in that;

(i) He failed to properly plan the audit;

(ii) He failed to identify the role of Bernard L. Madoff Investment Securities, LLC, 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) He failed to exercise sufficient and appropriate professional scepticism;

(iv) He 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) He 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) He failed to obtain sufficient and appropriate audit evidence of the operating effectiveness of the internal controls of Bernard L. Madoff Investment Securities, LLC, Fairfield Sentry's outside "service organization";

(vii) He failed to obtain sufficient and appropriate audit evidence to support the balance sheet item "Financial assets at fair value through profit or loss $7,173,165,000";

(viii) He 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 "$624,752,000".

18. Rule 206.1 of the Rules of Professional Conduct required a member engaged in the practice of public accounting, as Mr. Wall was, to perform their professional services in

accordance with the generally accepted standards of practice of the profession.

19. The failures alleged relate to the information provided by BLMIS. The PCC alleges, as set out in the last three particulars of both Allegations, that for both the 2006 and 2007 audits, Mr. Wall did not have sufficient and appropriate audit evidence to accept the representations made by BLMIS about the value of the net assets it held for Fairfield Sentry or the net income it earned for Fairfield Sentry. Three of the other five particulars of the Allegations, a failure to properly plan the audit, a failure to exercise sufficient and appropriate professional scepticism and a failure to appropriately consider and audit the increased risk of material misstatement, are related to and, in a sense, assume or rely on the basic failure, the lack of appropriate audit evidence with respect to BLMIS. The PCC asserts that Mr. Wall's failures to adhere to the required standards of the profession are so significant that they constitute professional misconduct.

20. Mr. Wall denies the Allegations and asserts that he did understand the role of BLMIS, that he did plan and carry out the audit appropriately taking into account the risk of misstatement and that he had sufficient and appropriate audit evidence (evidential matter) to give the opinions he did. He also submits that if he did fail to follow the standards of the profession, which he denies, it was an error in judgment which does not constitute professional misconduct.

21. The auditing standards of the profession with respect to the audit of Fairfield Sentry required the member to comply with the Generally Accepted Auditing Standards applicable in the United States at the relevant time as is clear from the audit opinion. These auditing standards are referred to generally, and in these reasons, as "US GAAS".

22. The PCC has asserted throughout this hearing that this is a standards case not a case involving moral turpitude. The PCC accepts that neither Mr. Wall nor anyone at PwC knew about the Madoff fraud or participated in any way in the fraud.

23. It is also important and relevant that US GAAS does not require an auditor to find fraud, if there is fraud. US GAAS does require an auditor to plan and perform the audit with due professional care and a sceptical mind and to be sensitive to the possibility of misstatements by reason of mistake or fraud. However, the failure of an auditor to detect fraud is not, in and of itself, either a failure to adhere to US GAAS or professional misconduct.

24. The issues of negligence or breach of contract and liability, if any, for the losses suffered by the investors (shareholders) of Fairfield Sentry is a matter for the courts, not the Discipline Committee, a professional discipline tribunal.

The Proceedings

25. There were a number of motions made prior to the commencement of the hearing and at the hearing itself. The Allegations are dated October 12, 2012. A motion was heard in November 2012, to defer the hearing and was dismissed.

26. A motion was heard on March 12, 2013, for a schedule of disclosure and a prohibition of the public disclosure of the Allegations. The decision was announced that day. The reasons of the Discipline Committee are dated November 20, 2014.

27. On January 14, 2014, a motion was made for an adjournment. The decision was announced that day. It should be noted that the composition of the panel which heard the evidence commencing on September 15, 2014, is different than the composition of the panel which heard the motions. On January 12, 2014, as is noted in the reasons dated November 20, 2014, the parties acknowledged and accepted the fact that the composition of the panel would change.

28. There were issues raised during the hearing which were argued and decided. Some issues related to the admissibility of evidence and were dealt with when raised. The issue of the admissibility of evidence referred to as “common practice” was argued after a motion record, written arguments and books of authorities were filed. The reasons for the decision made on June 2, 2015, allowing the evidence to be called are released with these reasons.

September 15, 2015

29. The hearing commenced with opening statements by Mr. Farley for the PCC and Ms. Nicklin for Mr. Wall. Before calling his witnesses, Mr. Devor and Dr. Holstrum, Mr. Farley filed an Agreed Statement of Facts (“ASOF”). Despite the length of the hearing, the voluminous documents filed (most of which were duplicated, some many times) there were relatively few disagreements about the relevant facts or the relevant standards. The disagreements about the facts and the disagreements about what the relevant standards required are dealt with hereinafter.

THE EVIDENCE

Agreed Statement of Facts

30. The ASOF which was marked as Exhibit 27, is 43 paragraphs long and has seven documents attached. These documents include: the Private Placement Memorandum (“PPM”) of Fairfield Sentry dated August 14, 2006; the Directors Report and the financial statements of Fairfield Sentry for each of the years ended December 31, 2006 and 2007; the Directors Report and financial statements of Fairfield Sentry for the year ended December 31, 2006; the Custodian Agreement between Fairfield Sentry and Citco Bank Nederland N.V. Dublin branch and Citco Global Custodian N.V. dated July 3, 2006; the Administration Agreement between Fairfield Sentry and Citco Fund Services (Europe) B.V. dated February 20, 2003; the

engagement letter of PriceWaterhouseCoopers ("PwC") with the FGG dated January 11, 2007. This letter, which was accepted and signed by Daniel Lipton, Partner and CFO of the FGG on January 30, 2007, appointed PwC the auditor of a number of funds including Fairfield Sentry for the year ended December 31, 2006. There is a similar letter dated October 17, 2007, agreed to by Daniel Lipton on November 23, 2007, which makes a similar appointment for the year ended December 31, 2007.

31. Fairfield Sentry, a company incorporated under the laws of the British Virgin Islands ("BVI") was the largest of the funds issued by FGG a group of investment funds based in New York. Fairfield Sentry offered shares to qualified investors, i.e. professional investors as defined by BVI law and the Irish Stock exchange. The investors were not to be citizens or residents of the United States and were to have a minimum net worth of $1,000,000. The minimum investment was $100,000.

32. Fairfield Greenwich (Bermuda) Ltd. ("FGBL") was responsible, according to the PPM, for the management of the various funds' investment activities. FGBL was registered as an investment advisor with the Securities and Exchange Commission ("SEC"). The various Citco entities referred to in paragraph 30 provided administrative and custodial services for Fairfield Sentry.

33. BLMIS was selected by FGBL, the investment manager, as execution agent of what was called the split-strike conversion strategy and substantially all of Fairfield Sentry's assets were to be held in segregated accounts at BLMIS which was a sub-custodian of Fairfield Sentry. In addition to being a sub-custodian, BLMIS was responsible for executing its proprietary split-strike conversion strategy and according to the PPM purchased and sold stocks, treasury bills, and options for Fairfield Sentry's account in accordance with the split-strike conversion strategy. PwC's work identified BLMIS as providing the prime broker–dealer services for Fairfield Sentry. Thus, as described below BLMIS, was a sub-custodian, executed the trades (was the prime broker-dealer) and was considered an investment advisor.

34. The PPM, at Page 9, under the heading "INVESTMENT POLICIES" states:

> The fund seeks to obtain capital appreciation of its assets principally through the utilization of the nontraditional options trading strategy described as "split strike conversion", to which the fund allocates the predominant portion of its assets.

35. The ASOF, with reference to pages 9 and 10 of the PPM, described the typical establishment of a position using the split-strike conversion strategy with respect to a basket of equity securities typically consisting of 35 to 50 stocks in the S&P 100 Index. It stated:

> The Split Strike Conversion strategy is implemented by Bernard L.

> Madoff Investment Securities LLC ("BLM"), a broker-dealer registered with the Securities and Exchange Commission, through accounts maintained by the Fund at that firm. The accounts are subject to certain guidelines which, among other things, impose limitations on the minimum number of stocks in the basket, the minimum market capitalization of the equities in the basket, the minimum correlation of the basket against the S&P 100 Index, and the permissible range of option strike prices. Subject to the guidelines, BLM is authorized to determine the price and timing of stock and option transactions in the account. The services of BLM and its personnel are essential to the continued operation of the fund, and its profitability, if any.
>
> The option transactions executed for the benefit of the Fund may be effected in the over-the-counter market or on a registered option exchange.

36. FGG and Citco received the BLMIS trade tickets two or three days after the trade date and also received monthly statements showing purchases and sales for Fairfield Sentry.

37. For several years before and for the year ended December 31, 2005, the financial statements of Fairfield Sentry were audited by PricewaterhouseCoopers Accountants, N.V. ("PwC Netherlands"). Fairfield Sentry's financial statements for these years were stated to have been prepared in accordance with International Financial Reporting Standards. When Fairfield Sentry's administrative services were transferred to Citco Canada, FGG retained PwC LLP (an Ontario limited liability partnership) to audit Fairfield Sentry's financial statements, beginning with the year ended December 31, 2006.

38. PwC's engagement letters for both the years ended December 31, 2006, and December 31, 2007, stated that the audit would be performed in accordance with US GAAS. The engagement letters addressed what PwC would consider with respect to internal control, the possibility of management override of controls which might result in misstatements due to error or fraud, and cautioned that the audit would not include a detailed audit of transactions such as would be necessary to disclose errors or fraud which did not cause a material misstatement and that audits done in accordance with generally accepted auditing standards in the United States may not detect a material fraud.

39. PwC's audits of the financial statements of Fairfield Sentry were conducted under the supervision and direction of Mr. Wall, the PwC partner responsible for releasing the audit report. Derek Hatoum, CPA, CA was the quality review partner and Patricia Perruzza, CPA, CA was the senior manager. The term "PwC audit team" sometimes used in these reasons includes these three members. As is apparent from the Allegations, only Mr. Wall, the partner responsible for the release of the audit report, has been charged.

Agreement on the Governing Standards

40. The Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA") promulgated the professional practice standards (GAAS) for auditors of US entities (AU 150). The standards were categorized as General Standards; Standards of Field Work; and Standards of Reporting. At the relevant time, the Standards of Field Work required the auditor: (first) to adequately plan the audit; (second) to have a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of tests to be performed; and (third) to obtain sufficient competent evidential matter through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion. [Note - copies of the AUs referred to in these reasons can be found in the appendix called US GAAS Appendix, in the case of AU 150 at Tab 1].

41. The ASB issued Statements on Auditing Standards (SAS) which were numbered and included specific guidance generally referred to as "AUs". AU 324, AU 330, and AU 543 are examples of guidance which are relevant in this case. The AICPA also issues Audit Guides, which are a lower level of authority than a SAS (or AU) but can also be relevant and important. The Audit Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* is such an Audit Guide and is relevant in this case. [US GAAS Appendix, Tabs 2, 3, 4 & 5]

42. The parties agreed generally on the relevant provisions of US GAAS, the AUs, and the provisions of the Audit Guide referred to above which were applicable but not on what they required or whether they had been complied with in this case. There were a number of copies of the relevant authorities filed. The first, Exhibit 202, is the exhibit filed when Mr. Devor was giving evidence. Exhibit 209, a one volume book including some of the authorities was filed when Dr. Holstrum was giving evidence. The member filed a number of exhibits of authorities, using a four-digit exhibit number, as will be apparent from the Exhibit list which is attached to these reasons. While the Exhibit List is cross-referenced (see the column "Comments") the panel does not recommend duplication of exhibits or different exhibit numbers for the same exhibits to future panels.

THE ORAL EVIDENCE

Mr. Devor

43. Mr. Devor's evidence-in-chief was given on September 15, 16 and 17, 2014. He was cross-examined by Ms. Nicklin on September 17, 29 and 30 and October 1, 2 and 6 and re-examined by Mr. Farley on October 6 and 7. The parties ordered daily transcripts of the proceedings. In all, there are 1507 pages of transcript of Mr. Devor's evidence, of which 1034 pages are of his cross-examination.

44. The PCC engaged Mr. Devor to investigate the PwC audits of the financial statements of Fairfield Sentry for the years ended December 31, 2006 and December 31, 2007. Mr. Devor, a US Certified Public Accountant, practised at Shechtman Marks Devor PC in

Philadelphia, Pennsylvania. He specialized in providing accounting, auditing and litigation services. After reviewing Mr. Devor's CV the panel accepted Mr. Farley's request to recognize Mr. Devor as an expert qualified to give opinion evidence. Ms. Nicklin, who did not oppose the request, made it clear that she would cross-examine with a view to seeking to limit the weight which the panel would give to Mr. Devor's testimony.

45. In support of his report, Mr. Devor produced a Document Brief, Exhibit 201 (Tabs 1 to 75) containing, among other documents, copies of the relevant working papers from PwC's files and transcripts of Mr. Devor's interviews with PwC personnel. Mr. Devor's report was filed and marked as Exhibit 203.

46. In his report, Mr. Devor set out the facts upon which he based his opinion. His investigation included a review of the relevant financial statements, the working papers of PwC and the submissions of PwC's counsel to the PCC dated January 15, 2010. He also interviewed among others Patricia Perruzza, CA; Stephen Wall, CA; Dorothy Sanford, FCA; Derek Hatoum, CA; and Robin Taylor, CA. Ms. Sanford and Mr. Taylor met with finance, investment, risk management, compliance, communications and IT personnel at FGG's New York office in March 2007. Ms. Sandford said, in her interview, she was not involved in the Fairfield Sentry audit, that she and Mr. Taylor did not test any operating effectiveness of controls, and in her words, "In March 2007, we did some work to develop a high level understanding of the Fairfield Greenwich control environment" (Exhibit 211, Tab 1, pages 20, lines 1-24 and 25, lines 1-2).

47. Mr. Devor stated in his report at paragraph nine:

> … it is my opinion that PwC did **not** conduct its audit of Fairfield Sentry's financial statements as and for the years ends December 31, 2006 and 2007 in accordance with GAAS which were in effect at the time that PwC's audits were performed.

48. In his report and in his evidence Mr. Devor referred to the standards in place at the relevant time and why he concluded that Mr. Wall had not complied with those standards. He did this with respect to each of the particulars set out in the Allegations.

49. Mr. Devor opined that the failure to identify or call BLMIS a service organization was a breach of the standard and a likely reason why the various particulars of the Allegations were true. In his opinion, as BLMIS provided the investment management/advisory, prime broker-dealer and sub-custodial functions (the "three functions"), BLMIS was a service organization within the meaning of AU 324 and thus had to be considered part of the information system of Fairfield Sentry and not an independent third-party. Thus, confirmations received from BLMIS were not from a party independent of Fairfield Sentry. The confirmations could only be used if Mr. Wall had sufficient and appropriate evidence (evidential matter) that appropriate internal controls at BLMIS were in place and operating effectively [US GAAS Appendix, Tab 2].

50. Mr. Devor set out the relevant parts, in his view, of the answers made by the PwC representatives to questions he asked when he interviewed them. He concluded after reviewing the working papers and interviews that neither Mr. Wall nor any other member of the PwC audit team had determined it was necessary to test the effective operation of the internal controls at BLMIS at the time the audit opinions were released, and that neither Mr. Wall nor anyone else on the PwC audit team were relying on the SEC*17a-5 Report - Independent Auditors' Report on Internal Control and Proof of Financial Condition* of Friehling & Horowitz ("17a-5 Report") as proof of the operating effectiveness of the internal controls of BLMIS when the audit opinions were released.

51. Mr. Devor opined that the17a-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"). He 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. [US GAAS Appendix, Tab 5]

52. Mr. Devor asserted that Mr. Wall failed to comply with the relevant provisions of Chapter 9 the Audit Guide for Auditing Investments in Securities published by the AICPA. In his view Scenario C of Chapter 9 the Audit Guide was "almost identical" to the circumstances at Fairfield Sentry. As a result, in his view, section 9.30 of the Guide, which provides, "The auditor gathers evidential matter that the broker-dealer has implemented the controls described in paragraph 9.28 and that those controls are operating effectively", required Mr. Wall to gather such evidential matter about the internal controls at BLMIS and he did not [US GAAS Appendix, Tab 6, p 141].

53. The footnote to 9.30 (Footnote 7) says "The evidential matter can be obtained in a variety of ways, such as a type 2 SAS No.70 report or special procedures performed by the broker dealer's internal or external auditors." [US GAAS Appendix, Tab 6, p 141]

Dr. Holstrum

54. Dr. Holstrum was called as a witness on October 7, 2014. Mr. Bellmore led the evidence asking that Dr. Holstrum be recognized as an expert qualified to give opinion evidence. Dr. Holstrum was cross-examined by Mr. Duffy on October 8, 2014, and re-examined by Mr. Bellmore. The transcript of the *voir dire* is 104 pages in length. The panel concluded Dr. Holstrum was an expert qualified to give opinion evidence. His report was marked as Exhibit 208 and the documents he referred to were marked as Exhibit 209.

55. Dr. Holstrum was a Professor in the School of Accountancy, University of South Florida from 1989 to 2004. He was employed by the Public Company Accounting Oversight Board

from 2003 to 2009, serving as the Associate Chief Auditor and Director of Research until November 2006 and as a Consultant, Office of Chief Auditor from November 2006 to January 2009. He carried on a consulting practice on Accounting, Audit and Financial Reporting Litigation at the time of the hearing. Dr. Holstrum was a member of the Auditing Standards Board (ASB) for four annual terms, January 1988 to January 1992, and was a member of Task Forces which developed a number of the standards relevant to this case.

56. The examination-in-chief of Dr. Holstrum by Mr. Bellmore commenced on October 8, and concluded on the next day of the hearing, October 15, 2014. Mr. Duffy's cross-examination of Dr. Holstrum began on October 15, 2015, and continued, for the next five days of the hearing, October 16, 17, 20, 21 and 22. Mr. Bellmore briefly re-examined Dr. Holstrum on October 23. The transcript of Dr. Holstrum's evidence, excluding the *voir dire,* is 1386 pages long, of which 1161 pages are of his cross-examination.

57. The important underlying facts on which Dr. Holstrum based his opinion are set out in his report. There were certain facts which were critically important to his opinion which should be mentioned. As is clear from the documents referred to in the ASOF and the site visit memo of the PwC team, Exhibit 201, Tab 26, from the outset of the engagement Mr. Wall was aware that BLMIS was responsible for three critical functions for Fairfield Sentry; first, the investment advisory/management function; second, the broker/dealer function; and third, the security custody function.

58. Dr. Holstrum opined that BLMIS met all five of the specified criteria, any one of which, according to AU 324.03, make BLMIS an integral part of Fairfield Sentry's information system for financial reporting. Accordingly, US GAAS required Fairfield Sentry's auditor (Mr. Wall) to identify the specific internal control procedures, which if in place and operating effectively, would provide reasonable assurance that the recorded investments actually exist. The auditor needed to have both an understanding of these controls and evidence that the internal controls were operating effectively. [US GAAS Appendix, Tab 2]

59. Dr. Holstrum provided an overview of his opinion at pages 4 to 8 of his Report, Exhibit 208. He concluded his report, in similar terms, at pages 53 to 55. While his conclusion was the same as Mr. Devor's, i.e. Mr. Wall failed to meet the required standards of the profession as particularized in the Allegations, and the reasons for his conclusion were similar, they were not exactly the same and there were some differences.

60. Dr. Holstrum, at page 55 of his report, set out Mr. Wall's failure to comply with key aspects of US GAAS with respect to key issues under five headings.

a) Failing to Respond Appropriately to the Role of Mr. Madoff and BLMIS in Fairfield Sentry's Information System and to Obtain Sufficient Appropriate Evidence of the Effectiveness of

BLMIS Control

In my opinion, Mr. Wall failed to properly respond to information about the role of Mr. Madoff and BLMIS in Fairfield Sentry's information system for financial reporting. 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 17 a–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*. [US GAAS Appendix, Tab 2]

b) Relying on the Work of the Other Auditor (Friehling and Horowitz)

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 the AU 543). [US GAAS Appendix, Tab 5]

c) Relying on Confirmations from BLMIS and not Obtaining Sufficient Appropriate Confirmations from Independent Counterparties

In my opinion, Mr. Wall failed to comply with GAAS requirements by relying on confirmations from BLMIS as though they were confirmations obtained from an independent third source. This was a failure to comply with GAAS requirements established by SAS 67 (AU 330), *The Confirmation Process*. In addition, Mr. Wall did not obtain sufficient appropriate confirmations from counterparties that were truly independent from and unrelated to BLMIS. [US GAAS Appendix, Tab 3]

d) Failing to Appropriately Consider Fraud Risk and to Demonstrate Professional Skepticism In Planning and Performing the Audit

In my opinion, Mr. Wall failed to properly and sufficiently consider the risk of fraud in BLMIS (which was part of Fairfield Sentry's

information system according to GAAS) and failed to demonstrate sufficient appropriate professional skepticism with respect to the evaluation of information about BLMIS and its critically important role in producing information in Fairfield Sentry's information systems for financial reporting. This was a departure from GAAS requirements established in SAS 99 (AU 316), *Consideration of Fraud in the Financial Audit.* [US GAAS Appendix, Tab 7]

e) Failing to Obtain Sufficient Appropriate Audit Evidence

In my opinion, the above failures were primary factors leading to Mr. Wall's overall failure to obtain sufficient appropriate audit evidence to provide reasonable assurance that Fairfield Sentry's investment transactions and assets were not materially misstated.

61. Dr. Holstrum did not agree that Scenario C in Chapter 9 of the Audit Guide applied in this case as is clear from pages 25 to 28 of his report. In his opinion, as the BLMIS - Fairfield Sentry circumstances were significantly different from the case study set out in Scenario C, Mr. Wall had to look directly to GAAS for guidance. Dr. Holstrum did agree (see pages 31 and 32 of his report) that if the case study, (Scenario C) applied, Mr. Wall had not complied with the requirements of AU 543.10 or 543.12 for relying on the work of another auditor. [US GAAS Appendix, Tab 5]

62. At page 29 of his report Dr. Holstrum set out a chart comparing the generic SAS 70 Report to the generic 17a-5 Report under five headings: "Purpose"; "Intended Use" (stated in report); "Reasonable Assurance"; "Items Reported on"; and "Depth of Report". He opined that GAAS required a SAS 70 Report or its equivalent and the 17a-5 Report was not the equivalent. He opined that the last paragraph of the 17a-5 Report precluded the use of the reports by PwC and dismissed the suggestion that PwC could use them, as they were provided by BLMIS, which could use them. Accordingly, in his opinion, Mr. Wall did not have any evidential matter which gave reasonable assurance that the key internal controls at BLMIS operated effectively.

63. Dr. Holstrum also noted that all of the information of the occurrence/existence of investments transactions came from BLMIS alone. Citco Canada, FGG and Fairfield Sentry could check the price BLMIS reported from independent sources, such as Bloomberg, and monitor what BLMIS said it did, but the only information of the actual occurrence or existence of the investments came from BLMIS. The operating effectiveness of the internal controls at BLMIS were not tested by Citco Canada, FGG or Fairfield Sentry.

Ms. Perruzza

64. Ms. Perruzza's examination-in-chief by Ms. Nicklin commenced on October 23, 2014, and continued on October 24, 27 and 28. Ms. Perruzza was cross-examined by Mr. Farley on

October 28, 29 and 31. She was re-examined by Ms. Nicklin on October 31. In all, there are 1080 pages of transcript of Ms. Perruzza's evidence, of which 437 pages are of her cross-examination.

65. When Ms. Perruzza gave evidence the case for the PCC was complete. The evidence called by the PCC and the cross-examinations made it clear that the fundamental issue was whether or not Mr. Wall, and by extension the PwC audit team, had sufficient appropriate audit evidence to accept and rely on (or use) the information (the confirmations) provided by BLMIS. In this regard whether PwC intended to use and could use the 17a-5 Reports was a crucial issue, if not the crucial issue.

66. Ms. Perruzza asserted, that the PwC audit team knew it was necessary to have both an understanding of the internal controls at BLMIS and the effective operation of those controls. She said the site visit the first year and the telephone confirmation the second year and the 17a-5 Reports (Exhibit 201, Tab 27 for the first year and Tab 28 for the second year) were the required evidence of both.

67. These issues were covered a number of times both in her evidence-in-chief and her cross-examination. She was confronted with statements she made in her interview with Mr. Devor. Ms. Perruzza asserted that she and the PwC audit team were not relying on the 17a-5 Reports the same way they were relying on the SAS 70 Report for Citco; but she insisted that the site visit memorandum (Notes of discussion) and the 17a-5 Reports provided evidential matter which entitled PwC to rely on the confirmations received from BLMIS.

68. While there are many excerpts from her evidence which set out this position, the evidence given under cross-examination at the end of the day on October 29, 2014, and the beginning of the next day of the hearing, October 31, (Transcripts page 4012 to page 4037) is relatively concise. She did refer to the audit procedures PwC had done with FGG and Fairfield Sentry, as well as the site visit memo (Notes of discussion). Of particular importance is her statement at page 4037, lines 5 - 9, in which she stated with respect to the assurance of operating effectiveness of the internal controls provided from the site visit memo:

> Well, it indirectly provides information that there is operating effectiveness. But the actual conclusion actually comes from their external auditors in the 17a-5 Report with respect to those key controls.

Mr. Hatoum

69. Mr. Hatoum's examination-in-chief by Mr. Duffy commenced on February 9, 2015, and concluded with his re-examination on the same day after he had been cross-examined by Mr. Bellmore. In all, there are 213 pages of Mr. Hatoum's evidence, of which 75 pages are of his cross-examination.

70. Mr. Hatoum agreed that one could call BLMIS a service organization on account of the

investment advisory services (Transcript, February 9, 2015, page 4284, lines 16 - 21) but he asserted that the label was not relevant as the audit team understood the functions BLMIS performed for Fairfield Sentry and intended to and did have an understanding of the internal controls at BLMIS and evidence that they operated effectively.

71. On the issue of whether or not PwC had tested the operating effectiveness of the internal controls at BLMIS, Mr. Hatoum said: “Obtaining the 17a-5 Report and the Statement of Financial Condition were the tests performed by PwC Bermuda in their visit” (Transcript, February 9, 2015, page 4345, lines 5 - 7). On cross-examination it was suggested that he made contradictory statements in his interview with Mr. Devor.

Mr. Wall

72. Mr. Wall’s examination-in-chief by Ms. Nicklin commenced on February 10, 2015, and continued on February 11, 12, 13 and March 17, 2015. Mr. Wall was cross-examined by Mr. Bellmore on March 17, 18, 19 and re-examined by Ms. Nicklin on March 20. A book of documents which Mr. Wall referred to was marked as Exhibit 3813.23. In all there are 1451 pages of transcript of Mr. Wall’s evidence, of which 396 pages are of his cross-examination.

73. The working papers of PwC which evidenced the consideration Mr. Wall gave to BLMIS, the functions it performed for Fairfield Sentry and the audit procedures followed were not voluminous. Mr. Wall had received and reviewed the working papers of PwC in the Netherlands for the prior year and returned them as required. He also reviewed the PPM of Fairfield Sentry dated August 14, 2006.

74. The working paper entitled "Gain an understanding of the key controls at Bernard Madoff and document the results of the cross fund testing performed” (Exhibit 201, 27-1, page 5674 and following) includes the emails dated in the period January 2007 to March 2007, between Mr. Wall and Mr. Scott Watson-Brown of PwC’s Bermuda's office. The emails show that Mr. Wall had agreed that Scott Watson-Brown and Linda McGowan were to visit BLMIS and discuss with Mr. Madoff the internal controls and procedures at BLMIS and provide Mr. Wall with a memorandum of their meeting. This meeting, as others before it, was not limited to gaining an understanding of the internal controls for Fairfield Sentry but also for other FGG funds audited by other offices of PwC. Mr. Wall’s share of the costs of this meeting was $3,000.00. The memorandum, entitled "Notes of discussion” (Exhibit 201, Tab 27-2, pages 5677 to 5683) was reviewed with Mr. Wall in detail. It had also been reviewed in detail with Ms. Perruzza.

75. The 17a-5 Report for the year ended October 31, 2006, and the Statement of Financial Condition referred to in the “Notes of discussion” (Exhibit 201, Tab 27-3, pages 5686 to 5688) were also reviewed in detail with Mr. Wall.

76. The equivalent working papers for the 2007 audit are found at Exhibit 201, Tabs 28-1, 28-2 and 28-3. They are similar to the documents for 2006, (Tab 27) except that the practice

for every other year was that rather than a visit with Mr. Madoff there was a telephone call which confirmed that there were no significant changes or issues noted. For the year 2007 the confirming telephone conversation was between Graham MacDonald of PwC Bermuda and the CFO of BLMIS, Frank DiPascali.

77. The audit plan for 2006 (Exhibit 201, Tab 21, p.12) and for 2007 (Exhibit 201, Tab 22, p.16) under the heading "Audit Approach, Risk Analysis and Audit Scope" refers to BLMIS. Under the sub-heading, "Audit Area", Bernard Madoff is listed as custodian, sub-custodian and prime broker. The following is set out under the heading "Audit Response":

> Through discussion and enquiry with Bernard Madoff, we will obtain an understanding of the key control activities as they relate to the operations and processes over the custodian, sub-custodian and prime broker functions. As these key controls are not covered in a section 5970/SAS 70 Report we will perform transaction testing on the investment strategy applied by Bernard Madoff for the applicable Funds.

78. Mr. Wall intended to rely on the blind confirmations he received from BLMIS. In his view confirmations were the "gold standard" for evidence of the existence of assets.

79. Mr. Wall acknowledged that BLMIS was not named as a service organization. He testified that the he and the PwC audit team understood the role and functions performed by BLMIS, as is evident from the audit plan, and that it was apparent BLMIS was the investment advisor.

80. It was Mr. Wall's position that Notes of the discussion with Bernard Madoff and the work done with FGG and Fairfield Sentry to understand their oversight and control environment provided the understanding of the internal controls at BLMIS and the 17a-5 Report was sufficient evidential matter of the effective operation of the key internal controls, the segregation of the investment advisory function, at BLMIS and thus he could accept the confirmations from BLMIS.

Ms. Hull

81. On the completion of Mr. Wall's evidence on March 20, 2015 Ms. Hull was called as a witness. Mr. Duffy lead the evidence with respect to her qualification that day and the next hearing day, March 23, 2015. Mr. Farley then cross-examined Ms. Hull, following which both counsel made submissions as to her qualifications to be an expert witness on March 23. Ms. Hull's CV was marked as Exhibit 3866.01-A.

82. The panel ruled Ms. Hull would be accepted as an expert witness, as a forensic investigator who could provide her views with respect to the fraud risk factors, and that in light of her limited experience with respect to audits conducted under GAAS, her evidence with respect to GAAS would be restricted to the consideration of fraud risk factors in the context of

a GAAS audit.

83. Ms. Hull's examination-in-chief commenced on March 24, 2015, and concluded on March 25. Her cross-examination began on June 2, 2015, after the motion referred to as the motion on common practice had been argued on June 1 and 2, and concluded on June 3, 2015. She was re-examined by Mr. Duffy on June 3. In all there are 484 pages of transcript of Ms. Hull's evidence, of which 171 pages are of her cross-examination.

84. Ms. Hull's evidence did help the panel to understand the Madoff fraud and the various concerns or issues raised about BLMIS and the Public Version of the report titled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme" by the Office of Investigations of the United States Securities and Exchange Commission (Exhibit 3866.42).

85. There were two articles published in 2001 which raised questions about Bernard Madoff's split-strike conversion strategy and the consistently good results BLMIS achieved with the strategy. Part of the PCC's case is that Mr. Wall did not properly address the risk of misstatement by reason of error or fraud and that the articles, which were generally known, were "red flags" which should have increased the heightened professional skepticism about BLMIS.

86. One article by Michael Ocrant was published in May 2001 in MAR/hedge. It was entitled, *Madoff tops charts: skeptics ask how* which raised questions and expressed doubts about Madoff's split-strike conversion strategy. [Exhibit 209, Tab 21]

87. The other article, also published in May 2001 was by Erin Arvedlund and appeared in Barron's Magazine entitled *Don't Ask: Don't Tell: Bernie Madoff is so secretive he even asks his investors to keep mum*. The article specifically mentioned Fairfield Sentry as a fund managed by Bernard Madoff. The article quotes people who expressed doubts about Bernard Madoff's performance and even quotes an investment advisor who pulled his investors' money out when Bernard Madoff could not explain how the fund was up or down in a particular month. [Exhibit 209, Tab 20]

88. The thrust of Ms. Hull's evidence was that the Madoff fraud was so sophisticated and well executed that it fooled regulators, investors, investment advisors and the others for decades and that a prudent auditor had no reason to give weight to the Ocrant or Arvedlund articles. BLMIS had been through investigations by the SEC between the publication of the articles and the PwC audits in question. BLMIS had been required to register as an Investment Advisor but no evidence of his fraud had been turned up. In short, BLMIS was well known, the results had been publicly questioned, there had been investigations and BLMIS carried on business under the scrutiny of the regulators. Accordingly, Mr. Wall should not have regarded the articles as red flags indicating the probability of fraud at BLMIS.

Mr. DeAngelis

89. Mr. DeAngelis' examination-in-chief by Ms. Nicklin commenced on June 22, 2015, and continued on June 23 and July 27. He was cross-examined by Mr. Bellmore on July 27, 28, 29 and 30. He was re-examined by Ms. Nicklin on July 30. In all, there are 1,029 pages of transcript of Mr. DeAngelis' evidence, of which 476 pages are of his cross-examination.

90. Mr. DeAngelis had prepared two reports. His first report, "Expert Witness Report of Anthony P. DeAngelis, CPA" was marked as Exhibit 3864, and his second report, entitled "Expert Witness Rebuttal Report of Anthony P. DeAngelis, CPA" was marked as Exhibit 3865. Mr. DeAngelis' CV was filed as Exhibit 3864.1. He was accepted as an expert witness.

91. Mr. DeAngelis opined, at paragraphs 15 and 69 of his report and in his oral evidence that BLMIS was not a service organization because of the provision of AU 324.03 which reads:

> The provisions of the section are not intended to apply to situations in which the services provided are limited to executing client organization transactions that are specifically authorized by the client, such as the processing of checking account transactions by a bank or the execution of security transactions by a broker. [US GAAS Appendix, Tab 2]

92. It was Mr. DeAngelis' opinion that BLMIS had a narrow discretion and effectively worked under FGG's direction. In support of this position he asserted that the parameters of the investment strategy were narrow, Fairfield Sentry could reject a trade within 10 days of the receipt of the trade ticket which was sent by mail two days after the transaction, FGG had a robust oversight of BLMIS and PwC had a good understanding of the control environment of Citco Canada, FGG and Fairfield Sentry.

93. As, according to Mr. DeAngelis, BLMIS was not part of the information system of Fairfield Sentry, PwC was entitled to rely on the confirmations received from BLMIS. The PwC audit plan had made it clear that it was not intending to rely on controls at BLMIS (to reduce testing) and it intended to perform substantive tests, namely obtain confirmation from BLMIS.

94. Mr. DeAngelis also expressed the view that even if BLMIS was a service organization, PwC had the requisite understanding of the internal controls at BLMIS and sufficient evidential matter of the effectiveness of the internal controls of BLMIS to accept the confirmations.

95. Mr. DeAngelis disagreed with Dr. Holstrum and Mr. Devor with respect to both the adequacy of the SEC 17a-5 Report, and whether Mr. Wall could use it.

96. Mr. DeAngelis testified that the 17a-5 Report provided sufficient evidence of the operating effectiveness of the key internal controls and the segregation of the investment advisory function, to enable PwC to rely on the confirmations from BLMIS. He disagreed with

Dr. Holstrum and Mr. Devor that the report required was a SAS type 2 Report (SAS 70 Report) or its equivalent, and compared the 17a-5 Report favourably to the SAS 70 Report for the purpose of evaluating the key internal controls of BLMIS, i.e. the internal controls with respect to the segregation of the investment advisor function.

97. Mr. DeAngelis testified that the prohibition in the 17a-5 Reports did not prevent Mr. Wall from using them as he received them from BLMIS, which could use the reports. He also testified the discussion Mr. Wall had with Mr. Lipton 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. [US GAAS Appendix Tab 5]

ISSUES

98. In its deliberations the panel concluded it should address the issues in the following order:

1. What burden of proof does the PCC have to meet? What is the standard of proof?

2. Assessing the expert evidence - deciding what expert evidence to accept.

3. Did Mr. Wall have sufficient appropriate audit evidence of the Assets and Income of Fairfield Sentry for the years ended December 31, 2006 and 2007? This issue will determine particulars (vi) (vii) (viii) of both Allegations. This issue also is relevant when considering particulars (i) (iii) and (v) of both Allegations.

4. Did Mr. Wall fail to exercise sufficient and appropriate professional scepticism? This issue will determine particular (iii) of both Allegations.

5. Did Mr. Wall fail to appropriately consider and audit the risk of material misstatement of the financial statements due to approximately 95% of the assets 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? This issue will determine particular (v) of both Allegations.

6. Did Mr. Wall fail to properly plan the audit? This issue will

determine particular (i) of both Allegations.

7. Did Mr. Wall fail 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? This issue will determine particular (iv) of both Allegations.

8. Did Mr. Wall fail to identify the role of Bernard L Madoff Investment Securities LLC? This issue will determine particular (ii) of both Allegations.

9. If one or more particulars are proven did Mr. Wall's conduct constitute professional misconduct?

ANALYSIS

First Issue - Burden of Proof

99. This is a discipline hearing, a civil proceeding, in which the burden of proof is on the PCC. The standard of proof requires the PCC to satisfy the panel on the balance of probabilities, i.e. that on the evidence it is more likely than not that the particulars of the Allegations made are true. This "more likely than not test" applies to factual matters and to the standards which applied and what they required.

100. The standard of proof, or burden of proof, does not move to the higher criminal standard of "proof beyond a reasonable doubt" because the issue is whether or not Mr. Wall's conduct constitutes professional misconduct. *(R v Wigglesworth,* [1987] S.C.J. No. 71; *F.H. McDougall* [2008] S.C. J. No. 54.

101. The evidence on which the panel is entitled to make its finding must be clear, cogent and convincing. The panel is entitled to consider all of the evidence before it, not just the evidence of the PCC. *Caruthers v College of Nurses of Ontario,* [1996] O.J. 4275; *R. v. Pickton,* [2010] 2 S.C.R. 198; *Barrington et al v ICAO*, 2011, ONCA 409).

102. In reaching its conclusions the panel must weigh the reliability and credibility of each witness; this includes expert witnesses with respect to matters the panel concluded are relevant to its decision. The panel is required to set out the major points in issue and provide an explanation for rejecting the evidence it rejects which does not mean the panel is required to address every issue raised by the parties. *Gray v Ontario* (2002), 59 O.R. (3d) 364 (C.A.); *Barrington v ICAO, 2011* ONCA 409).

103. As we said at the beginning of these reasons, "Our primary concern is to be clear on the basis for our decision, i.e. based on evidence we found to be clear, cogent and convincing,

our findings on the relatively few facts in dispute and the requirements of the applicable standards." It follows that evidence, including opinion evidence, which is different from the evidence on which the findings and conclusions are based has been rejected.

Second Issue - Assessing the Experts' evidence

104. The panel understood it had the obligation to weigh the evidence, and reminded the parties of this on a number of occasions. The panel also understood one of its tasks was to consider the credibility of the experts and decide which opinion to accept when the opinions differed.

105. The parties, to a substantial extent, agreed on the criteria we should apply when weighing the expert evidence, namely: 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; the expert's demeanour; and the internal and external consistency of the expert's testimony including his or her report.

106. Each party emphasized what they perceived to be the strengths of their experts and their evidence. Both parties were vigorous in their criticism of the other's experts, even asserting the other's experts acted more like advocates than independent witnesses. The member's submissions specifically included "motivation" in the list of factors which the panel should consider and attacked the credibility, experience and motivation of the experts for the PCC. Counsel for the PCC were equally vigorous in attacking the credibility of Mr. DeAngelis and Ms. Hull.

Mr. Devor

107. The member's submissions asserted that Mr. Devor's investigation was fatally flawed as a result of his lack of experience and expertise in the relevant field, specifically the audits of investment funds and broker dealers. They also asserted that he failed to ask critical questions to obtain relevant information and interview key witnesses. Counsel for the member attributed these faults to his motivation, which they assert, was to prove the PCC's case and thus he demonstrated a closed mind and focus (tunnel vision). The panel disagreed and found his evidence to be objective and credible.

108. Much of the member's defence rested on the 17a-5 Reports. Counsel for the member was particularly critical of Mr. Devor's questions when interviewing the members of the PwC audit team concerning these Reports and the intended use of or reliance on them. As will be clear from our analysis below, the panel does not agree with this criticism. The panel found that the testimony at the hearing of Mr. Wall, Ms. Perruzza and Mr. Hatoum with respect to the intended use and importance of the 17a-5 Reports was inconsistent with the working papers and the information they provided on their interviews with Mr. Devor. The panel does not doubt that Mr. Wall, Ms. Perruzza and Mr. Hatoum, who understandably and deservedly are respected members of the accounting profession, recognized a need to

understand the internal controls, but the panel concluded that it was the interviews with Mr. Devor that caused them to consider the utility of the 17a-5 Reports in the context of the need to have evidence of the effective operation of the internal controls.

Dr. Holstrum

109. Counsel for the member asserted Dr. Holstrum's evidence should be given less weight because of a lack of experience and an overly academic approach. The panel concluded his experience on the ASB, which establishes US GAAS from January 1988 to January 1992; and his participation in the development of and his knowledge of Audit Confirmations: SAS No. 67, *The Confirmation Process* (AU 330); Service organizations; SAS No. 70, *Service organizations* (AU 324); Using the Work of Other Auditors: SAS No. 64 (AU 543)" [pages 8 to 12 of his report] added weight and credibility to his evidence. His knowledge of the matters in issue and the perspective of someone who participated in the development of the standards in issue in this case was very helpful. While the time and energy spent on explaining some matters in pedantic detail was not well spent, the open-ended questions posed in cross-examination did not encourage brevity. [US GAAS Appendix, Tabs 2, 3 & 5]

110. Dr. Holstrum's evidence was consistent with that of Mr. Devor on what the panel regards as the essential issue. As will be apparent from our analysis (findings and conclusions) the panel agreed with the opinion of Dr. Holstrum (and Mr. Devor) that the PwC team could not use or rely on the 17a-5 Report as evidence of the operating effectiveness of the key internal controls at BLMIS.

111. Dr. Holstrum, as did Mr. Devor, 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. Audit evidence of what BLMIS held and earned for Fairfield Sentry was crucially important. Mr. Wall identified BLMIS as "the custodian, sub-custodian and prime broker", recognized there was no SAS 70 Report on BLMIS and decided to "perform transaction testing on the investment strategy applied by Bernard Madoff for the applicable Funds" as is set out in the audit plan for both years (see paragraph 77 above). While he said he recognized the functions BLMIS performed for Fairfield Sentry (which is borne out by the audit plan) he still treated BLMIS as if it were an independent third party and not part of Fairfield Sentry's information system. Confirmations from independent third parties are the "gold standard", but BLMIS was not a third party and the confirmations from BLMIS were not sufficient appropriate audit evidence and did not constitute evidential matter.

Ms. Hull

111. The panel did not accept that Ms. Hull was qualified to opine on auditing standards. It is somewhat ironic that counsel for the member, who challenged the experience of Mr. Devor

and Dr. Holstrum, proffered someone as an expert on auditing standards who had little experience as an auditor.

112. Ms. Hull did have considerable experience as a forensic accountant which the panel found helpful. One of the issues was the extent to which there were questions and concerns ("red flags") about BLMIS at the time of the audit. This was not an issue free of controversy. The report of the Office of Investigations of the SEC into the failure of the SEC to uncover the Madoff fraud (Exhibit 3866.042), referred to questions and issues which it called red flags which were known at the time of the audits or before and not just in hindsight. Ms. Hull, who was a member of the team of investigators for the report, concluded Mr. Wall did not fail to recognize red flags at the time of the audits.

Mr. DeAngelis

113. The panel found, using the criteria counsel suggested, that Mr. DeAngelis was the least objective and credible of the experts. He seemed more like an advocate than an unbiased objective expert witness. Much of the defence rested on his opinion that the functions performed by BLMIS did not mean it was a service organization, and that in any event BLMIS was entitled to use and rely on the 17a-5 Reports. The panel concluded Mr. DeAngelis' evidence and opinion on these two points were untenable and rejected his evidence.

Service organization

114. Only Mr. DeAngelis opined that BLMIS was not a service organization. His evidence at the hearing was consistent with his report (Exhibit 3864). He said at page 52, paragraph 107 of his report that:

> In my opinion, the parameters of the 'split-strike strategy' which BLMIS was engaged by FGG to execute on behalf of Fairfield Sentry were narrow and strictly defined such that BLMIS was effectively working at FGG's direction and incorporating minimal discretion of its own into the execution of the Fund's strategy.

115. He went on, in support of his position, to cite that the stocks had to be included in the S&P 100 stock index and transactions were subject to certain guidelines which among other things imposed limitations on what could be purchased. Mr. DeAngelis concluded, later in paragraph 107 (on page 53 of the report), that AU 324 did not apply as BLMIS was:

> AU 324 explains that the standards regarding service organizations "are not intended to apply to situations in which the services provided are limited to executing client organization transactions that are specifically authorized by the client, such as the processing of checking account transactions by a bank or the execution of securities transaction by a broker".

116. The panel did not find this plausible. This opinion ignored the fact that FGG and Fairfield Sentry considered BLMIS's role essential to the continued operation and profitability of the Fund and that BLMIS alone determined the price and timing of stock and option transactions, as set out above in paragraph 35, the PPM said:

> Subject to the guidelines, BLM is authorized to determine the price and timing of stock and option transactions in the account. The services of BLM and its personnel are essential to the continued operation of the fund, and its profitability, if any.

117. Mr. DeAngelis said that the fact FGG could reject the trade within 10 days of receiving the trading slip supported the view that BLMIS was executing trades at FGG's direction. This view ignored the fact that there is no evidence any trade was ever rejected. Mr. DeAngelis quotes Mr. Madoff as saying "trades were not permitted outside the order decisions generated by the trading model" but ignores the fact Mr. Madoff owned the trading model (strategy) and did not share it with anyone. Further, as Mr. Wall and Ms. Perruzza understood from their meeting with FGG in January 2007 (Exhibit 201, Tab 21, page 4600) Mr. Madoff alone decided when to leave and renter the market as he did four to six times a year.

118. This opinion of Mr. DeAngelis that BLMIS was not part of Fairfield Sentry's information system according to US GAAS was not shared at the hearing by Mr. Wall, Ms. Perruzza, Mr. Hatoum, Mr. Devor or Dr. Holstrum.

The 17a-5 Reports

119. The last paragraph of the SEC 17a-5 Reports, provided by Friehling & Horowitz, the auditors of BLMIS, reads as follows:

> This 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 and 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.

120. Mr. DeAngelis asserted that Mr. Wall could use the 17a-5 Reports, despite the limitation and prohibition set out in this last paragraph, because BLMIS (Company's management) could use it and BLMIS gave it to PwC. This in effect adds the words - "unless given to them by one of the specified parties" - which makes nonsense of the prohibition. The panel concluded the 17a-5 Report can only be used to demonstrate regulatory compliance. It is not evidence in a GAAS audit of financial statements.

121. Beyond this, if Mr. Wall was not prohibited from using the 17a-5 Reports, he could only use them if he complied with AU 543 which required him to inquire about the professional reputation of Mr. Friehling from appropriate sources and to discuss with Mr. Friehling the tests he had applied. He did not. Further, the panel found that Mr. Wall did not intend to rely on the 17a-5 Report at any time prior to the release of the second audit opinion. The essential factual underpinning, on which Mr. DeAngelis' opinion rests, was not as he assumed. [US GAAS Appendix, Tab 5]

Third issue - Sufficient Appropriate Audit Evidence

122. Allegation 1 relates to the year ended December 31, 2006 and Allegation 2 relates to the year ended 31 December, 2007. The last three particulars (vi), (vii) and (viii) of each Allegation assert that Mr. Wall failed to obtain sufficient and appropriate evidence

- of the operating effectiveness of the internal controls of BLMIS a service organization (vi);
- to support the balance sheet item - financial assets (vii); and
- to support the net gains set out in the income statement (viii).

123. These six particulars raise the central issue in this case. Did Mr. Wall have sufficient appropriate audit evidence of the existence of the assets purportedly held by BLMIS for Fairfield Sentry and the income purportedly generated at BLMIS for Fairfield Sentry? If he did not there was an audit failure.

124. Particulars (iii) and (v) of both Allegations are also relevant when considering whether or not the audit evidence is sufficient. Professional scepticism is always a requirement (particular (iii)). Basically Fairfield Sentry only had what BLMIS represented it had, and BLMIS provided not only the investment management/advisory function but also the prime broker-dealer and sub-custodial functions for Fairfield Sentry (particular (v)). There is no question 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.

125. Mr. Wall, Ms. Perruzza and Mr. Hatoum all acknowledged at the hearing that BLMIS was a service organization. The reports and testimony of Mr. Devor and Dr. Holstrum were that BLMIS was a service organization. Only Mr. DeAngelis, whose opinion the panel rejected, opined that BLMIS was not a service organization. As a service organization, BLMIS should have been considered by the PwC audit team as part of the information system of Fairfield Sentry. BLMIS was not an independent third party and PwC was not entitled to place any reliance on any information supplied by or processed by BLMIS without having sufficient appropriate evidence that the control environment and the specific internal controls related to the information provided (the occurrence of investment transactions and the existence of investment assets) had been suitably designed, placed in operation and operating effectively.

126. The evidence of Mr. Devor and Dr. Holstrum was that such sufficient appropriate evidence was usually provided by a SAS 70 Report. While not the only possible way to obtain the required evidence, the work done by an auditor to be satisfied about the internal controls at BLMIS would have to provide the same level of reasonable assurance of effective operation as a SAS 70 Report.

127. At the hearing, Mr. Wall, Ms. Perruzza, and Mr. Hatoum, acknowledged the standard required PwC (Mr. Wall) to have both an understanding of the internal controls of BLMIS and evidential matter of the operating effectiveness of the controls.

128. The Allegations use the terms "He failed to obtain sufficient and appropriate audit evidence" (Particulars (vi), (vii) (viii). Mr. Wall usually used the term "evidential matter" which is consistent with AU 543 and the Audit Guide. As set out in paragraph 60 above, Dr. Holstrum asserted Mr. Wall failed: to obtain **"**sufficient appropriate audit evidence of the effectiveness of BLMIS controls".

129. The panel understands US GAAS requires "evidential matter" to be "sufficient and appropriate audit evidence". However, even if there is a distinction between "evidential matter" and "sufficient and appropriate audit evidence", it does not matter because Mr. Wall did not have any evidence that the internal controls of BLMIS were operating effectively, and such evidence was essential before Mr. Wall could rely on the information (confirmations) received from BLMIS. Accordingly, he had no basis on which to support the assertion made about the balance sheet item on financial assets or the income on the income statement. The panel summarizes the seven specific reasons or findings for this conclusion below.

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, Friehling & 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 sections 9.28 and 9.30 and footnote 7 of the Audit Guide for auditing derivatives instruments hedging activities and investment insecurities were not satisfied.

The audit plan and evidence

130. In the audit plans for 2006 (Exhibit 201, Tab 21, p.4786) and for 2007 (Exhibit 201, Tab 22, p.16) under the heading "Audit Approach, Risk Analysis and Audit Scope" there is reference to BLMIS. Under the sub-heading "Audit Area" Bernard Madoff is listed as custodian, sub-custodian and prime broker. The following is set out under the heading "Audit Response":

> Through discussion and enquiry with Bernard Madoff, we will obtain an understanding of the key control activities as they relate to the operations and processes over the custodian, sub-custodian and prime broker functions. As these key controls are not covered in a section 5970/SAS 70 Report we will perform transaction testing on the investment strategy applied by Bernard Madoff for the applicable Funds.

131. The audit procedure to gain an understanding of the key control activities at BLMIS was a site visit by members of the PwC network, a procedure which had been carried out in the past by PwC personnel, who were not from the Toronto office, and were performed for all the FGG Funds. The memorandum reporting on the site visit of December 4, 2006, for FGG

Funds (Exhibit 201, Tab 27, page 5679 for 2006) was received as an attachment to an email from Scott Watson-Brown on January 19, 2007. Mr. Madoff provided a copy of the Rule 17a-5 Report and Statement of Financial Condition for 2005, and when the 2006 report and statement were available they were also provided. Mr. Wall received them by email dated March 1, 2007.

132. Every other year a phone call with BLMIS was used by the PwC network to determine if there was any significant change at BLMIS from the previous year. The email confirming that there were no significant changes or issues noted for the 2007 year was sent by Graham MacDonald on February 21, 2008 (Exhibit 201, Tab 28, p.17513). The 17a-5 Report for 2007 and Statement of Financial Condition were attached to the email confirming the telephone update from BLMIS.

133. The audit work done by the PwC audit team on the oversight of BLMIS by Fairfield Sentry, FGG or Citco Canada did not provide evidence that the internal controls at BLMIS were operating effectively. 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 from BLMIS.

134. While 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. The site visit provided the understanding of the key internal controls and the 17a-5 Reports were the evidentiary matter of the effective operation of the key internal controls at BLMIS. As the panel has set out in paragraph 129 above, the 17a-5 Reports were not sufficient appropriate evidence and could not be used by Mr. Wall. Accordingly, he did not have sufficient appropriate audit evidence (evidential matter) to conclude the internal controls of BLMIS, a service organization, operated effectively. Particular (vi) of both Allegations were proven.

135. Mr. Wall decided that he and the audit team would take a substantive approach and confirm 100% of assertions (financial information) made by Fairfield Sentry in the financial statements. In his interview with Mr. Devor, Mr. Wall said that he would rely on the “gold standard”, confirmations (from BLMIS) of the assets and income. The confirmation request made of BLMIS by PwC was a blind confirmation; it asked BLMIS to tell PwC the assets and income, it did not set out what PwC understood the information to be and ask BLMIS to confirm it.

136. Mr. Wall had identified the various functions that BLMIS performed for Fairfield Sentry and thus should have known BLMIS was part of the information system of Fairfield Sentry, and therefore should have concluded that any confirmations from BLMIS were not from an

independent third-party which PwC called for in their planning. The PwC audit team were not entitled to rely on the confirmations and thus failed to obtain sufficient and appropriate evidence to support the balance sheet item, financial assets as alleged in particular (vii) of both Allegations; and failed to obtain sufficient and appropriate evidence to support the Net Gains set out in the income statement, as alleged in particular (viii) of both Allegations. Particulars (vii) and (viii) of both Allegations were proven.

Fourth issue - Did Mr. Wall exercise appropriate professional scepticism?

137. In accepting the 17a-5 Reports as sufficient and appropriate evidence of the operating effectiveness of the internal controls at BLMIS, accepting confirmations which were not provided by an independent third party, and failing to appropriately inquire about the professional qualifications about Friehling & Horowitz, Mr. Wall failed to exercise sufficient and appropriate professional scepticism as alleged in particular (iii) of both Allegations. Particular (iii) of both Allegations were proven.

138. The panel was not persuaded that Dr. Holstrum's opinion that the failure to apply analytical review procedures was a basis for a finding of a lack of professional scepticism or improper planning. The panel did not accept Dr. Holstrum's conclusions that the proper application of analytical review procedures would lead one, at the planning stage of the audit, to conclude the results BLMIS achieved were either as a result of clairvoyance about what the market would do or fraud (page 39 of his report).

Fifth Issue - Audit risk as a result of 95% of the assets being at BLMIS

139. In accepting confirmations from BLMIS, and accepting the17a-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 Friehling & Horowitz, 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 as alleged in particular (v) of both Allegations. Particular (v) of both Allegations was proven.

Sixth issue - Did Mr. Wall fail to properly plan the audits?

140. If the audit plans did not require evidence of the operating effectiveness of the internal controls at BLMIS the audits were not properly planned. In light of the panel's finding that the only evidence Mr. Wall could claim to have, the 17a-5 Reports, were not evidence he could rely on, whether or not he planned to use or rely on the reports may seem moot. Even if it was clear that Mr. Wall and the PwC team planned from the outset of the audits to obtain and rely on the 17a-5 Reports, as PwC could not use them, the audits would not be properly planned. Particular (i) of both Allegations were proven.

141. However, the PCC asserts that not only did the member and the PwC team not intend

to rely on the 17a-5 Reports as evidence of the effective operation of the key internal controls at BLMIS when the audit opinions were released but this was their position even when the members of the PwC audit team were interviewed by Mr. Devor in November 2011. Considerable time and effort was spent at the hearing, and in the submissions, on this issue. Counsel for Mr. Wall strenuously objected to what they called the mischaracterization by the PCC of the answers given during the interviews and asserted the problem was that Mr. Devor did not ask the right questions.

142. The working papers, according to Rule 218 of the Rules of Professional Conduct, are to evidence the nature and extent of the work done on an audit. There 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 at BLMIS.

144. There is reference in the audit plans re BLMIS to "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. The 17a-5 Report for 2006 was mentioned in the memorandum of the site visit and obtained in the audit procedure to gain an understanding of the internal controls at BLMIS. Similarly, the 17a-5 Report for 2007 was obtained via the confirmation that there had been no change from the previous year. There is no working paper evidencing that the prerequisite conditions for use of another auditor's report required by AU 543 were satisfied in either year.

145. The various working papers contained in the exhibits dealing with planning only address the reliability of the Ernst & Young SAS 70 Report on Citco Canada. There is a reference to the fact that no SAS 70 Report is available for BLMIS but nothing about reliance upon a 17a-5 Report. This lack of documentation contrasts sharply with the evidence that Mr. Wall, Ms. Perruzza and Mr. Hatoum gave at the hearing and is consistent with the answers given by the PwC audit team in their interviews and the initial written response of PwC to the PCC.

146. The Initial Written Submissions and Document Brief of PricewaterhouseCoopers to the Professional Conduct Committee on January 15, 2010, (Exhibit 201, Tab 4) at page 43 reads as follows:

> Finally, Mr. Davidson observes that "the PWC auditors who performed the audit were not even aware that the person performing the audit of Madoff was not registered to do so". Here it is essential to recall that PWC was not auditing BLMIS, nor was it relying on BLMIS's auditor. No professional standard imposed upon PWC an obligation to verify the status of Friehling & Horowitz simply because that firm had signed the Rule 17a reports obtained by PwC. Again PwC notes that the purpose of obtaining these reports was not to audit BLMIS or its controls, but

> simply to gain an understanding of the operations and controls of BLMIS, as well as its regulatory status and standing, so as to help PwC plan its audit of the financial statements of Fairfield Sentry.

147. In her interview with Mr. Devor, Ms. Perruzza told him that PwC did not place any reliance on the controls at BLMIS in conducting its audit because PwC were not BLMIS's auditor (Ex 201, Tab 65, p. 35-36). Ms. Perruzza said PwC had to have an understanding of the controls but "at the end of the day we weren't going to rely on those controls" that PwC was going to test the investments substantively (Ex 201, Tab 66, p.51).

148. Mr. Hatoum said in his interview that the work done by the PwC network, the memorandum of the site visit and the 17a-5 Report had "no direct impact on either increasing or reducing testing that we would otherwise perform" that "it was a nice-to-have, not something that was necessary to complete the audit" (Exhibit 201, Tab 67, p.42 - 43).

149. If Mr. Wall intended to use or rely on the Friehling & Horowitz 17a-5 Report in either year, he had to make inquiries as to the professional reputation and standing of Friehling & Horowitz to one or more of: the AICPA; other practitioners; bankers and other credit creditors; or other appropriate sources. He was also obliged to obtain a representation from Friehling & Horwitz that they were independent (AU 543.10). He did not do so; in fact he did not even check with the AICPA to see if Friehling & Horowitz were licensed to perform audits in New York State, which he could have done with a search from his computer. It became known when the Madoff fraud was uncovered that Friehling & Horowitz were not qualified to issue audit reports. This knowledge is hindsight. The need to inquire about their professional reputation and what Friehling & Horowitz did, and were they independent, is not hindsight.

150. In his interview with Mr. Devor, Mr. Wall was asked questions about Friehling & Horowitz and the 17a-5 Report. The relevant extracts are set out below.

> Q. Were you familiar prior to receiving this report with the firm Friehling & Horowitz?
> A. No
>
> Q. Did you do any sort of testing at all or inquiry as to the credentials and experience of Friehling & Horowitz?
> A. I had made an inquiry of Dan Lipton, the CFO of the manager, Fairfield Greenwich, as to who BLMIS' auditors were.
>
> Q. And they replied Friehling & Horowitz?
> A. Friehling & Horowitz
>
> Q. Okay. Did you do an inquiry as to their specific experience and

credentials or anything like that?

A. Beyond that, no.

Q. What did he tell you?

A. Dan Lipton? Dan Lipton advised that Friehling & Horwitz was a small Jewish firm and that Bernie Madoff liked to keep the work in the Jewish community, and that was a reason he selected them, in that they were sort of a niche auditor, and I took some - - accepted that explanation as part of Fairfield Greenwich's other lines of business as doing due diligence and picking managers and sussing out these sorts of things. So I accepted Dan had a reasonable explanation. (Exhibit 201, Tab 65, p.42)

151. This second hand information is not evidence with respect to professional reputation and Mr. Madoff, who used Mr. Friehling as his auditor, is not an appropriate source. Further, there was no note or memorandum of this discussion in the working papers.

152. As Mr. Wall did not make reference in his report to the work of Mr. Friehling, AU 543.12 required Mr. Wall to consider a visit with Mr. Friehling or review his audit programs or working papers to find out what he did. There was no evidence that Mr. Wall considered doing any of those things. As for use or reliance on the report the following portion of the interview is relevant.

Q. If you could just again describe to me what reliance you might have placed on this.

A. We did not place auditor reliance on this report. We utilized the report to gain an understanding that BLMIS's operations as a broker/dealer were as described to us in the visit and that he was in compliance with the segregation rules and regulations of his regulator FINRA and the SEC as is detailed in this report. (Exhibit 201, Tab 65, p. 43-44)

153. The position of and the evidence given by Mr. Wall and members the PwC audit team at the hearing were inconsistent with and at times contradicted the answers given at the interviews and the initial response of PwC to the PCC. The difference in the answers at the interviews, the failure to clearly state the 17a-5 Report was evidence of the operating effectiveness of the internal controls - as opposed to a "nice-to-have, not something that was necessary to complete the audit" cannot be attributed to inept questions by Mr. Devor as asserted by counsel for Mr. Wall. If the 17a-5 Report was essential to the audit, as Mr. Wall and the PwC audit team said at the hearing, the working papers and the responses of Mr. Wall and the members of the PwC audit team to the PCC and Mr. Devor should have made that fundamentally important fact clear. Neither the working papers nor their answers in their

interviews made this clear.

154. The panel concluded that, at the time the audit reports were released, Mr. Wall (and others on the PwC audit team) did not intend to rely on or use the 17a-5 Reports as evidential matter supporting the conclusion that the internal controls at BLMIS operated effectively. As is said above, this issue is in some ways moot; particular (i) has been proven for both Allegations even if the plan had been to rely on the 17a-5 Reports. But this conclusion or finding that there was no such intent does have implications for the weight the panel can give to the evidence the PwC audit team gave at the hearing, and has serious negative implications for the opinion evidence of Mr. DeAngelis.

Seventh Issue - The risk of material misstatement due to Fraud risks and red flags

155. This was not an easy issue to deal with. First, the panel did find particular (iii) of both Allegations proven. Mr. Wall did not exercise sufficient and appropriate professional scepticism for the reasons set out above.

156. Particular (iv) of both Allegations asserts a failure to consider misstatement because of numerous fraud risk factors. The PCC asserts that there were red flags which should have alerted Mr. Wall to the possibility of fraud.

157. Given the fact that there was one computer system at BLMIS and one person ultimately controlled the advisory/front office function as well as the broker, accounting and custodial functions, which were said to be segregated (paragraphs (a) and (h) of the report of the site visit memo, Exhibit 201, Tab 27); Mr. Wall was required by AUs 314, 316, 319, 332 and the AICPA Audit Guide to be aware that there was a higher than normal risk of misstatement due to fraud. Further, the oversight provided by FGG, which depended at least in part on its personnel's annual site visit and the 17a-5 Report of Friehling & Horowitz, should not have minimized his professional scepticism. In particular, he should have realized the only evidence of the occurrence of actual trades and the existence of the T-Bills at the end of the year, came from BLMIS. [US GAAS Appendix, Tabs 4, 6, 7, 8, 9]

158. But whether he should have considered the risk of fraud because of red flags is a different issue. As we said above, the panel found Ms. Hull's evidence helpful although the question of "were there red flags indicating possible fraud?" is not easy to answer. The Ocrant and Arvedlund articles were stale, Bernard Madoff and BLMIS had been investigated a number of times by the SEC. It was known that he was required to register as an investment advisor. But fraud was not detected. In the end the panel concluded the evidence of the existence of red flags did not pass the clear, cogent and convincing test the evidence should meet to prove particular (iv) of both Allegations.

Eighth Issue - Was it necessary to label BLMIS a service organization?

159. Mr. Wall did not label BLMIS a service organization. However, the panel concluded he

did identify the various roles or functions that BLMIS provided for Fairfield Sentry. The problem was not a failure to label, it was a failure of an appropriate audit response to the circumstances identified. In this sense the last "assertion" of particular (ii) is right, the information from BLMIS was a "key audit area for which an audit response was necessary".

160. The panel does understand the suggestion that, if BLMIS had been identified as a "service organization", the internal PwC guidance may have prompted an appropriate audit response. Citco Canada was identified as a service organization and a SAS 70 Report was obtained for Citco Canada. The panel concluded, as we have set out above, the standard required an appropriate audit response from Mr. Wall; he should have known it with or without labelling BLMIS a service organization and he did not. The substantial fault was not a failure to label. The clear, cogent and convincing evidence proved the substantial fault, particulars (vi), (vii), (viii), (i), and (iii) of both Allegations, but the panel concluded that the evidence with respect to particular (ii) of the two Allegations was not clear cogent and convincing.

Ninth issue - Was Mr. Wall's conduct professional misconduct?

161. Counsel for the member, in their written submissions, asserts that there is a stringent test for professional misconduct; that if there is a responsible body of professional opinion that supports the conduct of the member a finding of professional misconduct cannot be made; and that both US GAAS and Ontario law preclude a finding of professional misconduct when an auditor exercises his skill and judgment within the range of the reasonable auditor trained and experienced in the industry. Counsel for the member also referred to a number of cases of courts and arbitrators dealing with the Madoff fraud.

162. In *Barrington v ICAO*, the Ontario Court of Appeal dealt with a finding of professional misconduct by the Discipline Committee and in doing so confirmed the test for professional misconduct in the context of a challenge that the error made was an error in professional judgment. The appeal from the decision of the Discipline Committee to the Appeal Committee of the ICAO was dismissed. The Application for Judicial Review to the Divisional Court was successful in part. However, the Court of Appeal for Ontario set aside the decision of the Divisional Court and upheld the decision of the Discipline Committee.

What constitutes professional misconduct?

163. The position of the Discipline Committee on what constituted professional misconduct was set out in its reasons as follows:

> DO THE BREACHES CONSTITUTE PROFESSIONAL MISCONDUCT?
>
> 327. The departure or departures from the required standards of the profession must be significant in order to constitute professional misconduct. In determining whether a departure is significant, both the nature of the conduct itself – the departure from the required standards –

and the impact of the departure[s] are considered.

328. The breaches proven by particulars i), iii), and iv) of Charge 1 and particulars ii), iii), iv), v), and viii) of Charge 2 are significant enough, in and of themselves, to constitute professional misconduct.

329. As these departures individually constitute professional misconduct, it follows that collectively, they constitute professional misconduct. Also, collectively, they reveal the essential nature of the misconduct, namely an improper exercise of professional judgment with respect to the reasonable suspicions about the Put and the failure to reconsider their planned auditing procedures. The auditors said that their skepticism was "sky high". However, with respect to the impugned conduct, the evidence disclosed that the auditors failed to exercise the professional scepticism required in the circumstances.

164. The Divisional Court held that the finding was a mere error in professional judgment. The Court of Appeal disagreed. The relevant excerpt *Barrington et al v ICAO*, 2011, ONCA 409 is set out below.

Whether it amounted to misconduct

[119] The Divisional Court considered that the DC at most made a finding of a mere error in professional judgment and did not examine whether the breach fell outside the range of acceptable conduct or was serious enough to constitute misconduct. At para. 233, the Court stated:

> However, even if the DC was of the view that there was a breach of the standard here, given their acceptance of Wiener and Chant's evidence, it did not explain, in respect of charges 1(iv) and 2(viii), why the error in judgment was so significant as to constitute professional misconduct warranting disciplinary sanction. One may surmise that the DC was concerned about the impact of the error – that is, a failure to report a liability of $3.7 million, which was in excess of one percent of liabilities – but the DC did not expressly state that that was the basis for its finding.

[120] I do not agree that the DC applied an incorrect test or that its decision was unreasonable in finding that Power and Russo committed professional misconduct.

[121] Read as a whole, and in the context of an expert tribunal

> reviewing technical standards, the reasons provide the basis for its decision and are sufficient for appellate review.
>
> [122] The DC articulated the proper test and the requirement that any departure from the standards of the profession must be so significant that it constitutes professional misconduct: para. 54. Similarly, after making the findings that the particulars were proven, the DC specifically addressed the issue of whether the departures from the required standards and the failure to comply with GAAP constituted professional misconduct. It found that the breaches by the members were "significant enough, in and of themselves, to constitute professional misconduct": paras. 327-29.
>
> [123] The DC measured both the nature of the departure and its impact. The auditors set materiality at $2 million. The DC expressly found that the effect of the breach of the standard on the 1997 financial statements was to understate Livent's liability by $3.7 million, which exceeded the level of materiality the auditors themselves had set for the audit. By definition, for this expert tribunal, the impact of the breach was obvious and significant.

165. 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.

A responsible body of opinion or common practice

166. The member's counsel assert that, if there is a responsible body of professional opinion that supports the conduct of the member, a finding of professional misconduct cannot be made. The panel does not think this is the law in Ontario. But even if it were, the defence of common practice would fail because there was no evidence of what other auditors did. Mr. DeAngelis, who acknowledged that "PwC's working papers stand on their own," opined 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" (Exhibit 3864, paragraphs 31 to 34). There are several difficulties with this opinion. He had seen no working papers of other auditors and no other auditor who did what Mr. Wall did was called. Mr. DeAngelis is speculating that other auditors both adhered to

the professional standards and did as Mr. Wall did, as his use of the word “supposedly” makes clear. The member called no evidence to support the speculation of Mr. DeAngelis and while the panel put little if any weight on his evidence in general it could put no weight on this speculation. Moreover, 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 US GAAS would have done so.

167. The cases dealing with medical malpractice or a breach of the standard by a doctor before his or her professional body differ significantly from this proceeding where the required conduct is codified. It would be unfair to hold a doctor, who practised at a hospital where the diagnostic facilities or equipment were not as sophisticated as those at another hospital, to the higher standard of the better equipped hospital. In those circumstances what another doctor would have done in similar circumstances may be a determining factor or the determining factor. Here the determining factor is the requirements of US GAAS.

Other cases

168. While a number of cases were referred to which involved the Madoff fraud, none of the cases heard the evidence this panel heard. In fact, the case which is closest involved the audit of Fairfield Sentry for the years ended 31 December 2003, 2004 and 2005 carried out by Mr. H.F.M. Gertsen of PwC N.V. in the Netherlands. A complaint was made against Mr. Gertsen by investors in Fairfield Sentry. A certified translation of the decision is found at Exhibit 3814.3.

169. The position of Mr. Gertsen with respect to the need to test the effectiveness of the internal controls at BLMIS was not the same as the position of the PwC audit team at this hearing or the conclusion the panel came to. The Disciplinary Council in the Netherlands set out and accepted Mr. Gertsen’s position, which included at page 8 of 14, in the lengthy paragraph at section 4.6.1 the statement:

> There was/is no rule obliging Gertsen to test the existence and functioning of BMIS’s internal controls.

170. The Disciplinary Council also said in the third paragraph of section 4.7.2 (bottom of page 10 and top of page 11 of 14) that Gertsen was entitled to assume that the supervision of Citco by the DNB and of BMIS by the SEC was proper. The following excerpts from the fourth paragraph, in section 4.7.2 (page 11 of 14) and the first sentence of the next paragraph are set out below.

> In view of this and likewise in view of Madoff’s reputation, as well as the information derived by Gertsen from the above-mentioned SAS 70 report on the internal controls at Sentry, from the underlying report by Ernst & Yonge dated 30 November 2005 and from the report of the visit to BMIS

> by PWC Bermuda personnel in December 2004, Gertsen was entitled when carrying out the substantive audit procedure to rely on the confirmations, as derived from the account statements, of the existence, ownership and value of the assets "managed" by BMIS, even where these originated from BMIS itself.
>
> For these reasons, it therefore cannot be said that Gertsen should have consulted with BMIS's auditor in order to obtain insight into the scope of the latter's audits.

171. Mr. DeAngelis quoted from the first paragraph of section 4.7.2 of this decision at paragraph 34 of his Expert Witness Report as follows:

> the provisions of the then applicable standards and guidelines, the information which the parties have alleged and proven provided sufficient justification for the unqualified auditor's opinions.

172. In fact, US GAAS imposed different standards. As the panel set out above, Mr. Wall did not comply with the requirements of US GAAS. It follows that while the audit is of the same client and the audit work done with respect to the information provided by BLMIS appears to be similar a comparison of the different standards applicable compel a different conclusion. Mr. Wall did not comply with the applicable standards in place.

CONCLUSION

173. For the reasons set out above, particulars (i) (iii) (v) (vi) (vii) and (viii) of both Allegations were proven. The finding of proven for any one of these particulars, in and of itself, proves the Allegation and constitutes professional misconduct. Particulars (ii) and (iv) of both Allegations were not proven.

174. The practice of the tribunals of CPA Ontario is to issue a Decision and Order separate from the reasons for the decisions and orders made. Accordingly, the Decision of the Discipline Committee will read as follows:

> THAT having seen, heard and considered the evidence, and the submissions of counsel for both parties, the Discipline Committee finds Stephen W.A. Wall guilty of Allegation Nos. 1 and 2, and guilty of professional misconduct.

175. In light of this decision, the panel will now deal with the issues of sanction and costs. The panel assumes that the parties will be able to agree on a process for the exchange of information with respect to these issues and more particularly that the PCC will make its position known to the member and the member will respond. The panel wishes to have the position of the parties and a summary of the submissions and copies of authorities they rely on

at least days before the hearing reconvenes. The panel asks the parties to advise the Adjudicative Tribunals Secretary when they will be ready to make submissions with respect to sanction and costs and the panel will then set the dates for the resumption of the hearing.

176. In the event it is necessary for directions to be given for the exchange of documents or resumption of the hearing the Chair of the panel will give such directions as are necessary.

DATED AT TORONTO THIS 20TH DAY OF MARCH, 2017

S.F. DINELEY, FCPA, FCA – DEPUTY CHAIR
DISCIPLINE COMMITTEE and CHAIR OF THE PANEL

MEMBERS OF THE TRIBUNAL:
R.J. ADAMKOWSKI, CPA, CA
R. CARRINGTON (Public Representative)
A.D. NICHOLS, FCPA, FCA
D.L. KNIGHT, FCPA, FCA

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

DISCIPLINE COMMITTEE

IN THE MATTER OF: Allegations against **STEPHEN W. A. WALL**, **CPA, CA**, a Member, under **Rule 206.1** of the Rules of Professional Conduct, as amended.

TO: Mr. Stephen W. A. Wall, CPA, CA

AND TO: The Professional Conduct Committee

REASONS
(Order made October 6, 2017)

1. This tribunal of the Discipline Committee of the Chartered Professional Accountants of Ontario (CPA Ontario) met on October 6, 2017 to hear submissions on sanctions and costs following the Decision issued by the tribunal on March 20, 2017, against Stephen W. A. Wall, a member of CPA Ontario. The Decision on the allegations of professional misconduct in the conduct of the audits of Fairview Sentry Limited for each of the years ended December 31, 2006 and 2007 reads:

> THAT having seen, heard and considered the evidence, and the submissions of counsel for both parties, the Discipline Committee finds Stephen W.A. Wall guilty of Allegation Nos. 1 and 2, and guilty of professional misconduct.

2. Mr. Paul Farley and Mr. Brian Bellmore appeared on behalf of the Professional Conduct Committee (PCC). Ms. Emily Nicklin and Ms. Cynthia Amsterdam appeared as counsel for Mr. Wall, who attended with them. Mr. Robert Peck attended the hearing as counsel to the tribunal.

3. The Order of the tribunal was made on October 6, 2017, at the conclusion of the hearing. The written Order was sent to the parties on October 12, 2017. These reasons, given pursuant to Rule 20.04 of the Rules of Practice and Procedure, include the Order, and the reasons of the tribunal for its Order.

4. At the commencement of the hearing, the following documents, which had been delivered by the parties and reviewed by the tribunal, were filed as exhibits:

Exhibit S1 – Costs Outline of the PCC
Exhibit S2 – Written Submissions of the PCC
Exhibit S3 – Authorities Brief of the PCC
Exhibit S4 – Submissions on Sanctions and Costs of Mr. Wall
Exhibit S5 – Brief of Authorities of Mr. Wall
Exhibit S6 – Written Submissions of the PCC in Reply
Exhibit S7 – Supplemental Authorities Brief of the PCC

5. Also, a memorandum setting out: sections 35, 38 and 70 of the *Chartered Professional Accountants of Ontario Act, 2017*; Rule 19 of the Rules of Practice and Procedure and Regulation 7-3 of CPA Ontario, which are relevant to the proceedings, was marked as Exhibit S8. The parties, who agreed that the memorandum be filed, had been provided with a copy of it prior to the resumption of the hearing.

6. When the exhibits had been filed, the Chair of the tribunal advised the parties that it would be

helpful if each counsel would, at the outset, advise the tribunal what conclusion he or she was asking the tribunal to reach. This request was made in light of the fact that while the tribunal had been told that there was a joint submission with respect to both the terms of the order imposing sanction and the quantum of the costs (the amount of the partial indemnity), it was apparent from the submissions that there were points of vigorous disagreement.

7. Mr. Farley, on behalf of the PCC, and Ms. Nicklin, on behalf of the member, confirmed that there was a joint submission on both the terms of the sanction to be imposed and the amount of the costs to be ordered. The parties advised the tribunal that the disagreements referred to in their submissions demonstrated that they had reached an agreement by somewhat different routes.

Submissions of the Professional Conduct Committee

8. Mr. Farley reiterated that this is a standards case and there was no moral turpitude alleged by the PCC against Mr. Wall or the team he led in the audits of Fairfield Sentry.

9. Mr. Farley submitted that while this is a joint submission on sanction and costs with the reasons to support it being set out in the factums of the parties, the ultimate decision lies with the tribunal as to the appropriateness of the sanctions sought.

10. Mr. Farley stated that the parties are recommending that an appropriate sanction in this matter would be: a written reprimand from the Chair of the tribunal; a fine in the amount of $125,000; and full publicity to all members and the public, including newspaper publication in *The Globe and Mail,* the *Toronto Star* and the *National Post*. An order is also sought for partial indemnity of $1.7 million in respect of costs, which represents approximately two-thirds of the actual costs incurred. Mr. Farley stated that the order should have a 30-day time period to pay the fine and costs along with the provision for non-compliance of a suspension for three months, followed by revocation.

11. Mr. Farley submitted the appropriate approach to sanction should be as in *Barrington,* the case most like this case. In *Barrington* three partners of a firm were found guilty of allegations under Rule 206 for failure to perform their professional services in accordance with generally accepted standards of practice in the audit of the financial statements of Livent Inc., a public company. That case involved a fraud by the company as well, but, as in this case, there was no suggestion that the auditors were in any way complicit in the fraud. The sanction imposed on each of the three members included a fine of $100,000 and notice disclosing the members' names in *Checkmark*, the *Globe and Mail*, the *National Post* and the *Toronto Star*. Mr. Farley also referred to other cases contained in the Authorities Brief including *Grunberg* where there was no suggestion of moral turpitude or a pattern of failing to comply with professional standards.

12. Mr. Farley submitted that, if the sanctions proposed by the parties are reasonable, the tribunal should accept the proposed sanctions as appropriate to satisfy the sentencing principles of general and specific deterrence and rehabilitation.

13. Mr. Farley submitted that the mitigating circumstances include that: there is no history of any previous matter before the Discipline Committee; there have been no further complaints since the audits in 2007 and 2008; in general, the standards of practice of Mr. Wall have been competent; and Mr. Wall's agreement to a joint sanction submission has saved time and money.

14. Mr. Farley submitted that the aggravating circumstances are that this was a significant audit failure involving billions of dollars in assets reported on the balance sheet for which Mr. Wall failed to

obtain sufficient and appropriate audit evidence. There was no basis to support the assertion that the financial statements fairly represented the assets. Contrary to Mr. Wall's testimony at the hearing on the charges, the tribunal found that he did not intend to rely on or use the 17a-5 Reports to support the conclusion that internal controls at BLMIS operated effectively. This change in testimony, from the evidence he and other members of the audit team gave in their interviews, extended the length of the hearing. Mr. Wall did not accept or admit any deficiency in the work performed. While Mr. Wall has a right to defend himself, he demonstrated no understanding that there was an audit failure.

15. Mr. Farley stated that while the principles of sentencing apply – specific deterrence, general deterrence and rehabilitation – deterrence is the overriding applicable principle in this case. The quantum of the fine must be significant to get the message across. The fine requested is the highest amount ever proposed, even more than *Barrington*, due to the aggravating factors not present in other precedent cases.

16. Mr. Farley submitted that Mr. Wall, other members of his audit team and like-minded members must fully comply with GAAS and the publicity will address this issue. Gaining an understanding that the audit work performed did not comply with the GAAS standards will impact Mr. Wall's rehabilitation. It is only in rare and unusual circumstances that no publication is ordered and Mr. Wall has agreed to the proposed publicity. Newspaper publication is proposed due to the nature of the public audit and the high profile of this matter.

17. Mr. Farley stated that the PCC was of the view that a suspension is not necessary in this case. There was no issue of dishonesty, lack of integrity or moral turpitude on the part of Mr. Wall. The misconduct occurred in isolated circumstances with no pattern of due care issues.

18. It was agreed by the parties that the PCC should recover a substantial portion of the costs incurred in the investigation and prosecution of the allegations, and disbursements. The costs agreed on are proportionate for the length of the hearing, which involved many witnesses including experts on US GAAS and experienced senior legal counsel. There is a reasonable expectation that Mr. Wall should pay a significant portion of the costs as the amount of hearing time was driven primarily by the respondent.

Submissions on behalf of Mr. Wall

19. Ms. Nicklin advised the tribunal that the PCC had agreed that the member could file two letters of reference as evidence with respect to sanction. The letter of Robert J. Muter, FCPA, FCA, a former partner of Mr. Wall, and Mr. Bill McFarland, FCPA, FCA, the senior partner and Chief Executive Officer of PricewaterhouseCoopers (PWC), were filed as Exhibits S9 and S10 respectively.

20. The letters said that Mr. Wall's audits had been reviewed many times by PWC, the Institute of Chartered Accountants of Ontario (now CPA Ontario) practice inspection program, Public Company Accounting Oversight Board and the Canadian Public Accountability Board, and there were no instances of inappropriate audit reports. Mr. McFarland said the discipline proceeding had a significant emotional and physical impact on Mr. Wall and that the failure of Fairfield Sentry, the Decision of the tribunal and the reasons already had, and would continue to have, a negative effect on Mr. Wall's career.

21. Ms. Nicklin submitted that the parties were in accord with the proposed joint submission on sanction. Publication in the newspaper should be similar to notices published in other CPA Ontario cases such as *Woodsford* and *Barrington*. The fine and costs proposed are reasonable in the

circumstances of the case. Ms. Nicklin emphasized this is a standards case, not a matter of dishonesty, moral turpitude or systemic practice failures. It is about the audit of one entity in an otherwise unblemished career. Mr. Wall fully cooperated with the investigation and throughout the proceedings before the PCC and the Discipline Committee.

22. Ms. Nicklin submitted that Mr. Wall was well within his rights to mount a vigorous defence to refute the allegations of the PCC and was successful in refuting certain of the alleged breaches of professional misconduct. Mr. Wall had the right to present expert evidence in his own defence and this should not be considered an aggravating factor.

23. Ms. Nicklin submitted that the tribunal must consider if the sanctions proposed are reasonable and fair, and are consistent with similar cases. The sanctions will have an impact on Mr. Wall's professional standing, his reputation and his livelihood. The costs proposed of $1.7 million are substantially higher than those ordered in the *Barrington* case and the fine is the highest ever proposed in Rule 206 cases.

24. Ms. Nicklin submitted that Mr. Wall and PCC are in agreement that rehabilitation and specific deterrence can be achieved without suspension. More than 10 years have passed since the audit without further incident in Mr. Wall's practice as he continues to deal with highly complex audits of funds, public companies, investment brokers and dealers with no issues arising about Mr. Wall's adherence to professional standards. Mr. Wall was found by the Discipline tribunal to be a respected member of the profession. The parties are in agreement that there is no need for a period of suspension or professional development courses and that the recommended reprimand, fine and publication will have a significant impact on Mr. Wall and other members of the profession.

25. Ms. Nicklin stated that Mr. Wall was able to refute some particulars of the allegations which should be taken into account in the calculation of the costs. Although the final costs proposed were arrived at differently by the parties, in the end there was agreement that the $1.7 million partial indemnification of the costs incurred was reasonable and appropriate.

Reply

26. In reply, Mr. Farley submitted that while Mr. Wall's submission relies on the assertion that he successfully refuted certain of the particulars advanced by the PCC and the tribunal did find that two of the eight particulars of each of the two allegations were not proven that the key particulars of the allegations were proven, and Mr. Wall was found guilty of both allegations.

27. Mr. Farley submitted that Mr. Wall's failure to comply with GAAS constituted a significant audit failure which should be taken into account during the sanction process. While the PCC does not take the position that Mr. Wall does not have the right to defend himself against allegations of professional misconduct, the Discipline tribunal has the right to consider remorse or acceptance of wrongdoing or the lack thereof which was the case here.

28. Mr. Farley stated that although the costs proposed are a joint submission, Ms. Nicklin "opened the box" by submitting that Mr. Wall had been successful on some particulars; there is no provision to parse particulars when the member has been found guilty of the allegation.

Order

29. After deliberating, the tribunal made the following Order:

IT IS ORDERED in respect of the Allegations:

1. THAT Stephen W. A. Wall (Mr. Wall) be reprimanded in writing by the Chair of the hearing.

2. THAT Mr. Wall be and he is hereby fined the sum of $125,000, to be remitted to the Chartered Professional Accountants of Ontario ("CPA Ontario'') within thirty (30) days from the date this Decision and Order is made.

3. THAT notice of this Decision and Order, disclosing Mr. Wall's name, be given in the form and manner determined by the Discipline Committee:
   a) to all members of CPA Ontario,
   b) to the Public Accountants Council for the Province of Ontario; and
   c) to all provincial bodies,
   and shall be made available to the public.

4. THAT notice of this Decision and Order, disclosing Mr. Wall's name, the fine of $125,000, where particulars of the misconduct can be found, and that costs were charged, be given by publication on the CPA Ontario website and in the *National Post,* the *Toronto Star* and *The Globe and Mail* newspapers. All costs associated with the publications shall be borne by Mr. Wall and shall be in addition to any other costs ordered by the committee.

5. THAT in the event Mr. Wall fails to comply with the requirements of this Order, he shall be suspended from membership in CPA Ontario until such time as he does comply, provided that he complies within six (6) months from the date of his suspension. In the event he does not comply within the six-month period, his membership in CPA Ontario shall thereupon be revoked, and notice of the revocation of his membership, disclosing his name, shall be given in the manner specified above, and in the *National Post,* the *Toronto Star* and *The Globe and Mail* newspapers. All costs associated with this publication shall be borne by Mr. Wall and shall be in addition to any other costs ordered by the committee.

IT IS FURTHER ORDERED:

6. THAT Mr. Wall be and he is hereby charged costs fixed at $1,700,000, to be remitted to CPA Ontario within sixty (60) days from the date this Decision and Order is made.

Reasons for Sanctions

30. It will be clear from the order that the tribunal found the proposed terms, with one point of clarification, appropriate and in these reasons we say why. With respect to the disagreements, some of which were passionate, given the joint submissions of the parties, as Ms. Nicklin acknowledged in her submissions, it was not necessary for the tribunal to resolve them and the tribunal agreed. However, the tribunal concluded that there were a few points made in submissions about costs which warranted comment.

31. The principles articulated by Justice Cory in *Re Stevens and the Law Society of Upper Canada* 55 O.R. (2d) 405 at page 411 with respect to the onerous responsibility when imposing sanction apply in this case as to all discipline cases. When imposing sanction, the tribunal is required to consider and

compare the member (offender) with other members who misconducted themselves (offenders) and to members who have not misconducted themselves (non-offenders); and to consider and compare the nature of the misconduct to other misconduct.

32. In its reasons for decision March 20, 2017, the tribunal set out the nature and extent of the professional misconduct. Given the nature of the misconduct and the consequences, a complete lack of audit evidence that supported the assertion the financial statements were presented fairly, few if any other standards cases in this province are as serious as this case.

33. In contrast, Mr. Wall's history and behavior subsequent to 2008 have demonstrated no practice issues. He is a competent and respected member of the profession who made a serious mistake. He has a good record and is highly regarded in his field of practice. There have been no other complaints about Mr. Wall's professional conduct, either before or after the audits in question nine and ten years ago. His firm has continued to entrust him with significant responsibilities. The PCC (rightly) does not suggest that he is not generally competent.

Applicable principles

34. The parties submit, and the tribunal agrees, that the principles of sanction which apply in this case are: general deterrence, specific deterrence and rehabilitation; and that the principle which is the most important and should have priority is deterrence, particularly general deterrence.

35. The essential question the tribunal must decide is whether the proposed sanction is appropriate and reasonable for the member and the misconduct in this case. If it is not, the tribunal would impose a sanction that the tribunal views as appropriate and reasonable. The ultimate question with respect to the proposed sanction was whether it would be sufficiently robust to serve the purpose of general deterrence.

36. Specific deterrence and rehabilitation are relevant. The discipline process itself usually has both a specific deterrent and rehabilitative effect on a member. This is particularly so in this case, which has taken significant time and expense.

37. The member has spent many days reviewing his audit and watching and listening to his audit and judgement being reviewed. Mr. Wall will not want to repeat the experience and no member reading the reasons will want to experience it either. While an investigation into a member's conduct is confidential, a hearing on an allegation is a public hearing and a determination of professional misconduct and the reasons therefore are matters of public record. The tribunal accepted the evidence of Mr. Muter and Mr. McFarland that the process itself has had an effect on Mr. Wall's health, mental and physical, and on his career. These facts and the fact this is the only instance of misconduct by Mr. Wall persuaded the tribunal that general deterrence, not specific deterrence or rehabilitation, should have priority in this case.

Reprimand

38. A reprimand is intended to make it clear to the member that his conduct has been unacceptable. It is intended as a specific deterrent and to prompt the member to rehabilitate himself. It will be a reminder of the hearing, which as we have said above, has already had a real effect on Mr. Wall.

The fine

39. The tribunal concluded that a fine of $125,000, the highest fine imposed on a member by the

profession in Ontario was appropriate and would serve the purpose of general deterrence. The amount of the fine and the fact it is the highest fine imposed should catch the attention of other members.

Notice

40. The publication of a notice disclosing the member's name has traditionally been seen as a necessary and effective way to achieve the principle of general deterrence. The parties rightly concluded that a term of the order requiring publication was necessary. The issue the tribunal had with the proposed notice was that it did not provide enough information about where a reader could find more information about the case.

41. The notice the member's counsel requested is consistent with notices in the past. The problem is such notice is no longer consistent with CPA Ontario's obligation to the public or its members. The reasons of the tribunals, including the decision and reasons of March 20, 2017, in this matter are posted on CPA Ontario's website, as is appropriate for a regulatory authority. The tribunal concluded this fact should be made known and accordingly made the order it did.

Suspension

42. As in *Barrington*, a suspension is within the range of sanction which could be appropriate in this case.

43. Unlike *Barrington*, where two of the three members sanctioned were retired and the impact of a suspension was not seen as particularly meaningful, in this case it could have a meaningful impact on Mr. Wall and thus serve as a deterrent. However, the impact of a suspension on a partner of a national firm can be blunted as the member can be given assignments which do not require that he or she be a CPA. The tribunal concluded a significant fine was a better deterrent, both general and specific, than a lesser fine and a suspension.

44. The tribunal concluded the fine, the notice and publicity the notice should generate and the appreciation most members will have of the impact on a member's life (health, family, career and immediate financial position) such misconduct can have, would adequately serve the principle of deterrence.

45. Further, while an order for costs is imposed as an indemnity, not a sanction, the amount ordered should make a strong impression on all other members and the public.

Costs

46. Section 38 of the *Chartered Professional Accountants of Ontario Act, 2017*, and Rule 19 of CPA Ontario's Rules of Practice and Procedure make it clear that the Discipline Committee may award the costs of the proceeding before it against a member if an adverse finding has been made against the member. The underlying principle is that the profession, as a whole, should not bear all of the costs of the investigation, prosecution and hearing resulting from the member's misconduct. The member takes no issue with respect to the authority to award costs against him, and as said, joins the PCC in recommending the cost award.

47. In this case, the PCC has followed its usual practice and filed a Cost Outline which sets out what it thinks would be an appropriate amount for costs if a full indemnity were to be ordered. This "appropriate full indemnity" does not include all of the costs which CPA Ontario has incurred in the

investigation, prosecution and hearing. In this case, the appropriate full indemnity set out by the PCC totals approximately $2.6 million. The PCC, again as is its usual practice, asks for a percentage of this amount, in this case 66% which is $1,700,000 ($1.7 million).

48. Counsel for the member agrees that the costs award should be $1.7 million. But counsel for the member asserts the appropriate full indemnity would be $2.2 million not $2.6 million and that the $1.7 million is 75%, not 66% of what would be an appropriate full indemnity. Almost half of the member's written submissions (70 of the 166 paragraphs) are devoted to the issue of costs, much of it to the calculation of the appropriate full indemnity.

49. There is no question that this case has been expensive. The investigation, prosecution and hearing have required much time and considerable expertise. The parties agreed on the partial indemnity of $1.7 million and the tribunal concluded it was fair and reasonable.

50. Given the agreement with respect to the $1.7 million the tribunal concluded that the disagreement about the appropriate full indemnity did not need to be addressed in detail. However, the tribunal does wish to comment on a few points.

51. In her oral submissions Ms. Nicklin referred to the fact Mr. Wall had not been found guilty on four of the 16 particulars. Discipline tribunals have rejected the proposition that costs should be awarded on a percentage of particulars proven basis. This is not a case where an allegation which is separate and distinct from the other allegations was dismissed.

52. In civil proceedings in Ontario, the Court awards an amount for costs which it thinks is fair and reasonable for the unsuccessful party to pay to the successful party. One of the factors the courts consider when determining what is fair and reasonable is the reasonable expectation of the unsuccessful party. Thus, the unsuccessful party's own costs are a relevant factor. In this case the tribunal had a good sense of the cost of the hearing. The member was represented by three counsel who also had another lawyer or lawyers in attendance with them much of the time. The hourly rates of the member's experts were higher than the rates of the PCC's experts. One of the many factors considered by the tribunal was that the member did not provide information about the costs he incurred.

53. The tribunal did review the Costs Outline of the PCC and found both the suggested appropriate full indemnity of $2.6 million and the proposed award of $1.7million reasonable.

DATED AT TORONTO THIS 14th DAY OF DECEMBER, 2017

S.F. DINELEY, FCPA, FCA – DEPUTY CHAIR
DISCIPLINE COMMITTEE and CHAIR OF THE PANEL

MEMBERS OF THE TRIBUNAL:
R.J. ADAMKOWSKI, CPA, CA
R. CARRINGTON (Public Representative)
A.D. NICHOLS, FCPA, FCA
D.L. KNIGHT, FCPA, FCA