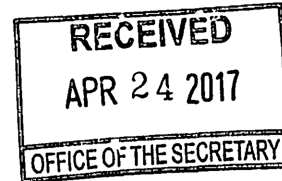
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17651

Administrative Law Judge
Cameron Elliot



In the Matter of

ADRIAN D. BEAMISH, CPA,

Respondent.

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I. PRELIMINARY STATEMENT

This is a case the Court will not have seen the likes of before. Respondent Adrian D. Beamish has a spotless record leading more than 500 audits in the course of a decades-long career. He oversaw highly qualified audit teams who spent many hundreds of hours a year conducting a diligent audit of Burrill Life Sciences Capital Fund III, L.P. ("Fund III" or the "Fund"), a private venture capital fund, over a period of many years. Mr. Beamish and his teams validated that the financial statements were accurate in all material respects, including confirming that certain payments from the Fund to its General Partner were properly accounted for and repeatedly disclosed to the Fund's sophisticated investors. The one member of management who has testified in this matter still stands behind the financial statements. And the Fund's subsequent auditor, even with the benefit of hindsight, issued a clean audit opinion confirming the account balances audited by Mr. Beamish's team.

The Enforcement Division, presented with a conscientious auditor with an unblemished record, diligent audits, repeated disclosure of an allegedly improper set of transfers, and no subsequent changes to the accounting by another independent auditor, has nonetheless seen fit to seek to destroy Mr. Beamish's career. And this is despite the fact that the Fund's financial statements were never filed with the Commission and that any concerns with Mr. Beamish's work fall entirely outside the Commission's own processes. This Court should not countenance this clear misapplication of the Rules of Practice. This proceeding and this Court can effect justice here, and rein in this and associated agency overreach.

The Division's approach here suggests a fundamental misunderstanding of the financial reporting process and the auditor's role within that process. As an initial matter, financial statements are the responsibility of management, not the auditor. Additionally, the users of the financial statements—in this case, highly sophisticated institutional investors—are responsible for actually studying the reported financial information with reasonable

diligence. An auditor's role is limited to conducting an audit of the financial statements and issuing an audit opinion stating that (1) the auditor has performed an audit in accordance with Generally Accepted Auditing Standards ("GAAS"); and (2) the financial statements, taken as a whole, conform with Generally Accepted Accounting Principles ("GAAP") in all material respects. Both of these statements were made in the relevant audits by Mr. Beamish and, in all cases, were accurate.

At the hearing, Mr. Beamish, along with Scott Burger (manager for the FY 2009 – 2011 audits) and Jonas Balsys (manager for the FY 2012 audit) will testify that the team's audits complied with GAAS: The auditors diligently assessed risks, tested controls, tested transactions, and evaluated the adequacy of financial statement disclosures in accordance with relevant professional standards. These witnesses will also testify that, as a result of the work they performed, the team attained reasonable assurance that the financial statements complied with GAAP in all material respects. Helena Sen, Burrill & Company's former Controller, will corroborate that the financial statements were prepared in accordance with GAAP.

The Court will also hear from four experts, each of whom will testify that the Division's case against Mr. Beamish is meritless. Gary Goolsby, formerly the managing partner at Arthur Andersen charged with overseeing risk management for the entire firm, will state that, in his expert opinion, Mr. Beamish and his team did examine the financial statements in accordance with GAAS. William Holder, Dean of the USC Leventhal School of Accounting, will testify that the financial statements complied with GAAP in each of the relevant years. John Riley, who has had top positions within the Commission and in private practice, will state that he would never have expected a case against Mr. Beamish, based on historic practices, and that such a case should not have been brought here. Howard Scheck, likewise a former senior official for the Commission, will confirm that this case is entirely

outside the Commission's jurisdiction based on past practice, and based on his deep experience, Mr. Beamish poses no threat to the agency's processes.

This brief will preview these arguments in some detail. It will, in turn: (1) present the relevant factual background; (2) demonstrate that the financial statements and the related disclosures complied with GAAP; (3) establish that the relevant audits were performed in accordance with GAAS; (4) explain that 17 C.F.R. §201.102(e)(1)(ii) ("Rule 102(e)") is not applicable to the current case; and (5) confirm that no relief is warranted under Rule 102(e) on these facts.

II. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

A. Adrian Beamish Is a Diligent and Accomplished Audit Professional with an Exemplary Record.

Mr. Beamish, a 46-year-old, highly accomplished accountant, lives with his wife and three school-aged children in Northern California.[1] He began his career as an accountant in 1992 at a mid-sized firm in the United Kingdom, joining PwC's UK affiliate in 1995. In 1998, he joined PwC's San Jose, California office, and his success in that role led PwC to promote him to partner in 2006.[2] He is a California Certified Public Accountant and an active member in good standing of both the American Institute of Certified Public Accountants and the Institute of Chartered Accountants in England and Wales.[3] He has never faced any disciplinary matters, nor, outside of this proceeding, has any regulatory body questioned the quality of his work.[4]

Mr. Beamish has experience across a number of industries, including pharmaceuticals, technology, consumer goods, industrial products, and venture capital.[5] Mr. Beamish has particularly deep experience and expertise in auditing life sciences and venture

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[1] Ex. 4 [Beamish Background Questionnaire] at 1-2.
[2] Ex. 1182 [Beamish Test.] at 13:14-14:20; Ex. 4 [Beamish Background Questionnaire] at 7, 10.
[3] Ex. 1182 [Beamish Test.] at 14:13-17; Ex. 4 [Beamish Background Questionnaire] at 8.
[4] Ex. 1182 [Beamish Test.] at 14:18-20; Ex. 4 [Beamish Background Questionnaire] at 8.
[5] Ex. 1182 [Beamish Test.] at 15:21-24.

capital companies. In 2011, he was named as Market Team Leader (MTL) for PwC's San Jose Life Sciences & Venture Capital Market Team.[6] In this position, Mr. Beamish led about 150 professionals (including partners, managers, and staff), and was responsible for training in auditing, accounting, compliance with risk management policies, and Partner and people development. Mr. Beamish has also spoken about and become an industry leader on best practices in venture capital accounting.[7]

In his ten years as a partner at PwC, Mr. Beamish has signed audit opinions on over 500 financial statements, including a significant number of venture capital funds.[8] Mr. Beamish has never had a significant restatement or a negative review of his work.[9] Over the past ten years, Mr. Beamish has been subject to either a PCAOB or PwC inspection in five separate years—including 2014 and 2015—and his inspection results have been fully compliant each year.[10] PwC awarded Mr. Beamish an exemplary service award, one of the most significant awards PwC offers partners for the quality of their work, for his service stepping in and improving the performance on one particular audit.[11]

B. Fund III Was a Well-Established and Respected Venture Capital Fund Run by an Experienced Management Team.

1. Fund III Formation and Structure

Fund III was a private biotech venture capital fund organized as a limited partnership in late 2005 with one General Partner (Burrill Life Sciences Capital Fund III Partners, L.P.,

[6] Ex. 1182 [Beamish Test.] at 18:1-4.
[7] Ex. 1129 [Scheck Rep.] at 10; Ex. 1182 [Beamish Test.] at 18:1-9.
[8] Ex. 1129 [Scheck Rep.] at 10.
[9] Of the 500 audit opinions Mr. Beamish has signed, there has only been one restatement, and that only affected a single footnote. This was due to a spreadsheet error which impacted the calculation of the internal rate of return. In an abundance of caution, Mr. Beamish decided issuing a restatement was appropriate. *See id.*
[10] *Id.* at 11.
[11] *Id.*

the "GP") and 21 limited partners.[12] The limited partners together committed over $280 million to finance Fund III's investments.[13]

Fund III was part of a family of funds managed by G. Steven Burrill ("Burrill") through his various related entities, organized under the umbrella of Burrill & Company LLC, which Burrill founded in 1994.[14] The members of the Fund III GP included Burrill (who owned 30% of the partnership's shares), Burrill Capital, LLC (a related entity Burrill wholly owned), Burrill & Company's chief legal officer, and various of its managing directors.[15]

Under the terms of the LPA executed by the Fund III limited partners, the GP had "the sole and exclusive right to manage, control, and conduct the affairs of" Fund III, "and to do any and all acts on behalf of" Fund III.[16] Steven Burrill executed the LPA on behalf of the GP.[17] Additionally, the operative agreements for the GP provided that the decisions and actions of the GP could be made by any of its individual members, which included at all relevant times Mr. Burrill.[18] The GP conducted Fund III's business operations through its management company (Burrill & Company) and its related investment adviser, Burrill Capital Management.[19] For sake of easier understanding, the following illustrates the entities' relationships:

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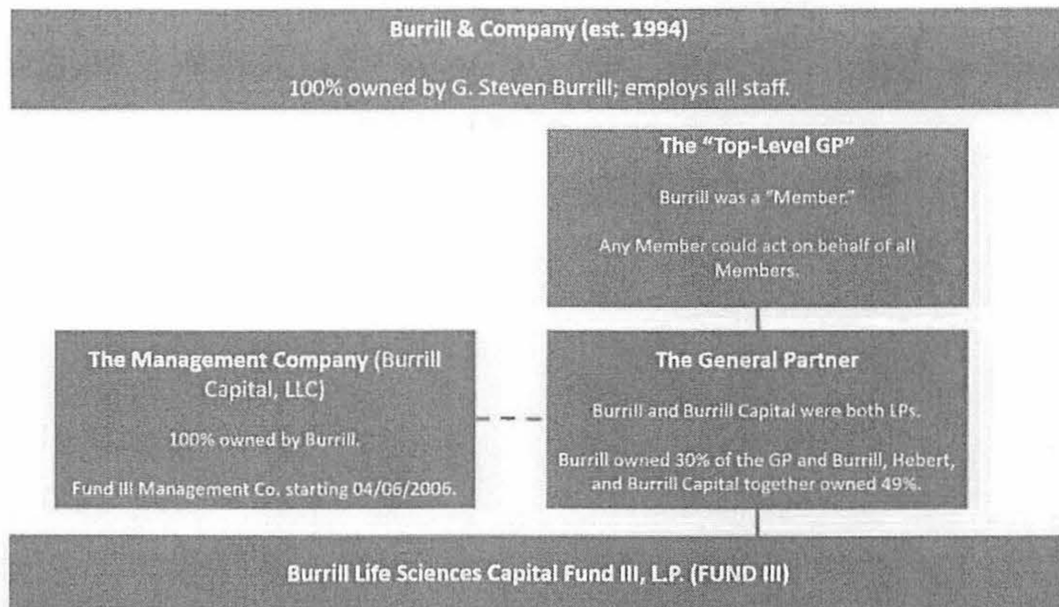
[12] Stipulated Facts ¶ 6.
[13] Stipulated Facts ¶ 10.
[14] *See* Ex. 1223 [Burrill & Company Entities Chart] at PWC 15927.
[15] Ex. 1216 [Fund III Partners Amended and Restated Limited Partnership Agreement], Schedules A & B.
[16] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00616.
[17] *Id.* at PWC 00653.
[18] *See* Ex. 1216 [Fund III Partners Amended and Restated Limited Partnership Agreement] at §§ 4.1.1, 4.1.2. The General Partner of Fund III was managed by a "Top-Level" General Partner, Burrill Life Sciences Capital Fund III Management, LLC, whose members again included Mr. Burrill and others. Ex. 1215 [Fund III Management Agreement] at §§ 4.1.1, 4.1.2.1. The Top-Level General Partner agreement provided that "all decisions or actions which this Agreement provides may be made by "the Members" may be made by any Member acting individually unless as otherwise indicated." *Id.* at § 4.1.1.
[19] Ex. 1221 [Burrill Capital and Fund III Management Agreement]; Ex. 1224 [Burrill & Company Operating Agreement].

BURRILL & COMPANY – FUND III STRUCTURE



2. Burrill and His Management Team Were Experienced Professionals With Outstanding Reputations, Credentials, and Stability

The day-to-day management of Fund III's operations were handled by four highly credentialed personnel. Burrill, the founder and CEO of Burrill & Company, had previously spent 26 years as an audit partner at Ernst & Young.[20] He served on the boards of directors of established scientific and educational organizations and spearheaded conferences, presentations, and the publication of The Burrill Report, a monthly review of biotechnology investment research.[21]

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[20] Stipulated Facts ¶ 32; Ex. 1240 [G. Steven Burrill's Burrill & Company Profile]; Ex. 1318 [Article: "You Can't Google Insight: Up Close with Steve Burrill" posted on mendelspod.com]; Ex. 1319 [Article: "State of Biotech Turns to State of Disbelief with Fraud Allegations against Steve Burrill" posted on mendelspod.com].

[21] Ex. 1240 [G. Steven Burrill's Burrill & Company Profile]; Ex. 1318 [Article: "You Can't Google Insight: Up Close with Steve Burrill" posted on mendelspod.com]; Ex. 1319 [Article: "State of Biotech Turns to State of Disbelief with Fraud Allegations against Steve Burrill" posted on mendelspod.com].

Victor Hebert, the Chief Administrative Officer and Chief Legal Officer of Burrill & Company and a member of the GP, enjoyed a similarly elevated reputation.[22] Hebert spent over 40 years as a corporate attorney, including over 25 years as a partner (as well as Chairman of the Management Committee from 1981 to 1993 and Co-Chairman from 1987 to 1993) at Heller Ehrman LLP, a prestigious San Francisco-based law firm.[23]

Helena Sen served as the Controller for the company and, in that capacity, managed the finances for all the Burrill entities for many years.[24] Before joining Burrill & Company, Sen had worked as an internal auditor, as a CPA, and as a corporate controller.[25] Jean Yang, the Burrill & Company Accounting Manager, reported to Sen and handled accounting tasks for all of the Burrill entities.[26] Yang had worked in accounting positions starting in the early 1990s, including working for four years with Sen herself, who recruited Yang to Burrill & Company.[27] Overall, the team was well-respected, well-informed, cohesive, and remarkably stable. As explained below, the audit team could and did properly rely on them to provide explanations of process and controls, transactional information, accounting records, and financial statements that they prepared. Over the course of many years (and audits of many other related private investment funds), the management team never withheld information, made contradictory statements, or otherwise gave cause for concern.

3. The Limited Partners Were Highly Sophisticated Investors

Fund III's limited partners—the users of Fund III's audited financial statements at issue in this matter—were highly sophisticated and knowledgeable. They were generally institutional investors, including state pension funds, "fund of funds"-styled hedge funds, and

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[22] Stipulated Facts ¶ 33; Ex. 1226 [East Bay Times Article]; Ex. 1239 [Victor Hebert's Burrill & Company Profile].

[23] Stipulated Facts ¶ 34; Ex. 1239 [Victor Hebert's Burrill & Company Profile].

[24] Ex. 1187 [Sen Dep.] at 25:4-18.

[25] *Id.* at 22:13-23:8.

[26] *Id.* at 27:9-20, 28:8-17.

[27] Ex. 1204 [Division Notes of Yang Interview] at SEC-BEAMISH-NOTES-0000117-119.

Fortune 100 companies like Monsanto, Kraft Foods, and Procter and Gamble.[28] The investors committed capital to the Fund in sums ranging from $1 million to $50 million.[29] In signing the LPA, each investor expressly represented that it was accredited and had "such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Partnership."[30]

Each limited partner received financial statements on a quarterly basis and audited financial statements on an annual basis.[31] In addition, the LPs were provided a hard copy of the audited financial statements at the annual meeting, at which the financial performance of the Fund was discussed by Mr. Burrill and other members of management, and the limited partners had the opportunity to ask any questions of management they may have had.[32] Beyond the financial statements themselves, Fund III's limited partners had the right under the LPA to inspect the Fund's complete books and records at any time (upon reasonable notice), had contact information for members of the General Partner, and would be given access to the Fund's auditors and accountants to discuss the finances of the Fund upon request.[33]

C. The Fund III Audits Were Thorough, Comprehensive, and Benefitted from Mr. Beamish's Familiarity with the Venture Capital Industry and Burrill Funds.

Mr. Beamish served as engagement partner for PwC's audits of multiple Burrill funds from 2006 through 2012, giving him a deep knowledge of the fund complex, its management team, and the accounting practices of the funds.[34] Mr. Beamish had particularly deep experience and expertise in auditing life sciences and venture capital companies. Several

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[28] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement], Schedule of Partners at PWC 00671-673.
[29] *Id.*
[30] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] § 7.4 at PWC 00617-618.
[31] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] §§ 9.4, 9.5 at PWC 00634; Ex. 1193 [Fong Dep.] at 108:16-109:5.
[32] Ex. 1193 [Fong Dep.] at 134:21-135:8, 139:2-140:24.
[33] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] § 9.3 at PWC 00633-634.
[34] Stipulated Facts ¶¶ 39-40.

high-performing PwC managers supported Mr. Beamish in his work on the Burrill accounts over the years. Scott Burger, a senior manager with substantial experience in auditing venture capital funds, assisted Mr. Beamish for the 2009, 2010, and 2011 year-end audits.[35] In 2011, after Mr. Burger left PwC to join a leading venture capital firm, Mr. Beamish added two experienced managers, Jonas Balsys and Nahum Lan, to assist with the FY 2012 audit.[36] Both Messrs. Balsys and Lan had experience auditing venture capital funds.[37] For the audits that are the subject of the OIP (*i.e.*, the audits of Fund III financial statements for financial years 2009, 2010, 2011, and 2012), between five and six PwC auditors were staffed on the engagement at a time and, all told, the team spent many hundreds of hours per year conducting the audit.[38]

As Mr. Beamish and his team were well aware, for investment funds like Fund III, one section of the financial statements—investment valuation—typically comprises the largest portion of the Fund's assets (here between 83% and 90% in the relevant years), and is most subject to risk of material misstatement due to the extent of management judgment involved in valuing the investments.[39] Mr. Beamish and his audit team accordingly spent the bulk of their time testing this section of the Fund's financials.[40] In connection with management's duty to estimate the value of the Fund's investments, the Burrill team agreed (on PwC's recommendation) to hire valuation specialists from Grant Thornton LLP.[41] The PwC team also consulted PwC's own internal valuation specialists.[42]

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35 Ex. 1186 [Burger Test.] at 13:22-14:18, 20:1-7, 21:4-16.

36 Ex. 1184 [Balsys Dep.] at 11:12-24, 13:2-6, 17:23-18:11, 22:17-24:10; Ex. 1192 [Lan Dep.] at 31:16-32:18.

37 Ex. 1184 [Balsys Dep.] at 28:4-22, 274:23-275:17, 281:24-282:13; Ex. 1192 [Lan Dep.] at 32:13-18, 33:20-34:4, 53:3-12.

38 Ex. 1102 [2009 Kick-Off Meeting Workpaper] at PWC 06161; Ex. 1078 [2010 Kickoff Meeting Agenda Workpaper] at PWC 16243; Ex. 1052 [2011 Team Discussion Regarding Risks of Material Misstatement Workpaper] at PWC 21510; Ex. 1011 [2012 Preliminary Meeting Workpaper] at PWC 22654.

39 Ex. 1133 [Goolsby Rep.] at ¶¶ 37, 49.

40 Ex. 1184 [Balsys Dep.] at 148:4-23, 327:13-328:4.

41 Ex. 1184 [Balsys Dep.] at 279:16-280:4, 302:23-303:15; Ex. 1183 [Beamish Test.] at 300:17-301:25; Ex. 1133 [Goolsby Rep.] at ¶ 52.

42 Ex. 1184 [Balsys Dep.] at 303:16-24; Ex. 1133 [Goolsby Report] at ¶ 52.

The Division does not allege that PwC's audit of Fund III's investment valuations was in any way improper. Instead, the Division's allegations of improper conduct relate only to the testing of certain transfers that Fund III made to its General Partner and certain affiliates (referred to herein as the "Relevant Transfers").[43] The Relevant Transfers represented between 5% and 7% of the total assets in the relevant period.[44] The audit work that the PwC team performed in connection with the Relevant Transfers was nonetheless substantial.

First, the team performed risk assessments in every year and determined the risk associated with the Relevant Transfers to be "normal," and not "significant."[45] In addition to brainstorming areas of potential risk as an audit team, team members also interviewed relevant individuals knowledgeable of the Fund's operations that could help the auditor in identifying risks of material misstatement, including Yang (all years), Sen (all years), Hebert (2010-2012), Hanham (2010), Fong (2011-2012), and Burrill (2009).[46] None of these stakeholders mentioned any improper conduct or risk of fraud.[47]

Second, the auditors tested certain key controls that were in place at the Fund. In preliminary discussions regarding internal controls, the team learned that Fong and Hebert had been appointed to overlook and supervise expense claims by the personnel of Burrill & Company. The audit team validated in each year that (a) cash disbursements were properly approved and authorized;[48] (b) bank reconciliations were being properly performed and

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[43] *See* OIP, filed October 31, 2016.

[44] Ex. 1133 [Goolsby Rep.] at ¶ 49.

[45] Ex. 1133 [Goolsby Rep.] at ¶ 53; Ex. 1103 [2009 Risks Report Workpaper]; Ex. 1082 [2010 Risks Report Checklist]; Ex. 1069 [2011 Risks Report Workpaper]; Ex. 1014 [2012 Risk of Material Misstatement in Prepaid Expense Workpaper]; Ex. 1015 [2012 Financial Statement and Disclosures May Workpaper].

[46] Ex. 1111 [2009 Fraud Risk Assessment Memo] at PWC 05866; Ex. 1093 [2010 Fraud Risk Agenda Workpaper] at PWC 15932; Ex. 1066 [2011 Fraud Risk Agenda Workpaper] at PWC 22691; Ex. 1029 [2012 Risks of Material Misstatement Due to Fraud or Error Workpaper] at PWC 28440.

[47] Ex. 1111 [2009 Fraud Risk Assessment Memo] at PWC 05866; Ex. 1093 [2010 Fraud Risk Agenda Workpaper] at PWC 15932; Ex. 1066 [2011 Fraud Risk Agenda Workpaper] at PWC 22691; Ex. 1029 [2012 Risks of Material Misstatement Due to Fraud or Error Workpaper] at PWC 28440.

[48] Ex. 1059 [2011 Cash Disbursements Are Reviewed and Approved Workpaper]; Ex. 1040 [2012 Cash Disbursements Are Reviewed and Approved Workpaper].

reviewed[49]; and (c) financial statements were being reviewed by Burrill and disseminated to LPs and other members of the GP.[50]

Finally, the team conducted extensive substantive testing of the Relevant Transfers, including holding discussions with management to obtain an understanding of the nature of the balance and the underlying transactions[51], obtaining the general ledger detail to determine the nature of the additions and reductions to the balance[52], vouching 100% of the cash disbursements to bank statements[53], and recalculating the amounts of the management fees earned and agreeing the result to the amount recorded in the financial statements.[54]

Moreover, as the facts and circumstances changed, Beamish and the PwC team responded, performing additional testing as needed. In 2011, when the balance of the receivable had grown to $13.4 million, the team took specific measures to validate that the management fees expected to be earned over the life of the Fund (without extension) would be adequate to repay this balance. They calculated the amount of fees yet to be earned (or the "runway") against which the prepayment of fees could be offset and found that expected future fees were substantially greater than the $13.4 million receivable balance.[55] In 2012, the $17.9 million balance for the first time exceeded the management fee runway. Through

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[49] Stipulated Facts ¶ 35; Ex. 1062 [2011 Bank Reconciliations Workpaper]; Ex. 1085 [2010 Bank Reconciliations Are Performed Workpaper]; Ex. 1018 [2012 Bank Reconciliations Workpaper].

[50] Ex. 1133 [Goolsby Report] at ¶ 45; Ex. 1095 [2010 Inquiry With Personnel Knowledgeable of Control Workpaper]; Ex. 1070 [2011 Business Performance Reviews – Quarterly Financial Reporting to Investors Workpaper]; Ex. 1039 [2012 Business Performance Reviews – Quarterly Financial Reporting to Investors Workpaper]

[51] Ex. 1104 [2009 Prepaid Expense Analysis Workpaper]; Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 19336; Ex. 1057 [2011 Prepaid Expense Testing Workpaper] at PWC 22046; Ex. 1027 [2012 Prepaid Expense Testing Workpaper] at PWC 27630.

[52] Ex. 1104 [2009 Prepaid Expense Analysis Workpaper]; Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 19336; Ex. 1057 [2011 Prepaid Expense Testing Workpaper] at PWC 22046; Ex. 1027 [2012 Prepaid Expense Testing Workpaper] at PWC 27630.

[53] Ex. 1104 [2009 Prepaid Expense Analysis Workpaper]; Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 19336; Ex. 1057 [2011 Prepaid Expense Testing Workpaper] at PWC 22046; Ex. 1027 [2012 Prepaid Expense Testing Workpaper] at PWC 27630.

[54] Ex. 1109 [2009 Recompute Management Fee and Testing Workpaper] at PWC 09391; Ex. 1094 [2010 Management Fee Recalculation Workpaper]; Ex. 1055 [2011 Recompute Management Fee Workpaper] at PWC 22257; Ex. 1041 [2012 Test Management Fees Workpaper] at PWC 27857.

[55] *See* Ex. 1065 [2011 Future Management Fee Calculation Workpaper].

discussions with Hebert, Sen, and Yang, Mr. Beamish and his team received assurances that the General Partner could look to its capital account for repayment.[56] PwC also obtained a representation letter signed by Burrill, Hebert, Sen, and Yang stating that "the Management Company intends to pay this amount to the Partnership from future distributions to the General Partner and from Management Company funds."[57] PwC then validated the valuation of the General Partner's capital account ($15.3 million) and determined that adding this amount to the remaining runway of future management fees resulted in an amount that far exceeded the $17.9 million prepayment balance.[58]

D. The Disclosures

In each year from 2009 to 2011, the Fund III financial statements disclosed both the fact and the amount of the Relevant Transfers. The Statement of Cash Flows reported the amount of Relevant Transfers paid that year; the Statement of Assets, Liabilities and Partners' Capital (*i.e.*, balance sheet) reported as an asset line item the outstanding balance of prepaid expenses; and a footnote disclosure entitled "Related Parties" disclosed that these Relevant Transfers represented a receivable due from the General Partner, a related-party of the Fund. In FY 2012, the footnote was expanded; the further disclosure included that the related party receivable would be repaid by the Management Company from General Partner distributions and Management Company funds. (The Division contends that these disclosures were improperly described as "prepaid expenses" rather than "prepaid management fees," but this is a distinction without a difference. As described further below, Fund III essentially had no other material expenses; each year, management fees represented between 95–99% of the Fund's expenses, and thus there is no other explanation for this expense. The Division also plans to quibble with whether the GP or Management Company

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[56] Ex. 1028 [2012 Prepaid Expense Workpaper].
[57] Ex. 1009 [2012 Management Representation Letter].
[58] Ex. 1133 [Goolsby Rep.] at ¶ 80-81.

would repay; given these were the same small group of people, it is another distinction without a difference.)

The specific disclosures in the financial statements each relevant year are as follows:

Year	Disclosures
2009[59]	• The Statement of Assets, Liabilities and Partners' Capital contains a line item titled "Prepaid expenses (Note 5)" reporting a balance of $5,757,233. • The Statement of Cash Flows reports the changes in "Prepaid expenses" for 2009 of $3,944,650. • The Statement of Operations contains a line item titled "Management fee (Note 4)" in the amount of $5,265,948 (95% of the total expenses of $5,534,047). • Note 5, under the header "Related Parties," discloses that "Prepaid expenses at December 31, 2009, includes a $4,927,374 receivable from the General Partner."
2010[60]	• The Statement of Assets, Liabilities and Partners' Capital contains a line item titled "Prepaid expenses and other receivables" reporting a balance of $10,443,467. • The Statement of Cash Flows reports the changes in "Prepaid expenses and other receivable" for 2010 of $4,686,232. • The Statement of Operations contains a line item titled "Management fee, net (Note 4)" in the amount of $5,304,748 (95% of the total expenses of $5,605,717). • Note 6, under the header "Related Parties," discloses that "Prepaid expenses at December 31, 2010 includes $9,259,317 receivable from the General Partner."
2011[61]	• The Statement of Assets, Liabilities and Partners' Capital contains a line item titled "Prepaid expenses and other receivables" reporting a balance of $14,904,884. • The Statement of Cash Flows reports the changes in "Prepaid expenses and other receivable" for 2011 of $4,461,448. • The Statement of Operations contains a line item titled "Management fee, net" in the amount of $5,345,948 (94% of the total expenses of $5,708,210). • Note 6, under the header "Related Parties," discloses that "Prepaid expenses and other receivables at December 31, 2011 includes $13,374,569 receivable from the General Partner."
2012[62]	• The Statement of Assets, Liabilities and Partners' Capital contains a line item titled "Prepaid expenses and other

[59] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20031, PWC 20036, PWC 20038, PWC 20046.
[60] Ex 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 35996, PWC 36001, PWC 36003, PWC 36012.
[61] Ex 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43398, PWC 43404, PWC 43406, PWC 43414.
[62] Ex 1004 [Fund III, L.P. 2012 Financial Statements] at 2, 8, 10, 20.

Year	Disclosures
	receivables from related party" reporting a balance of $17,952,059. • The Statement of Cash Flows reports the changes in "Prepaid expenses and other receivable" for 2012 of $3,047,175. • The Statement of Operations contains a line item titled "Management fee, net" in the amount of $5,630,594 (95% of the total expenses of $5,931,684). • Note 6, under the header "Related Parties," discloses that "Prepaid expenses and other receivables from related party at December 31, 2012, include $17,922,059 receivable from Burrill Capital, LLC. Burrill Capital, LLC (the "Management Company") is the management company of the General Partner."

Despite these disclosures year after year, to PwC's knowledge, no LP ever expressed concern about the increasing receivable due from the General Partner.

PwC resigned as auditor for the Burrill Funds following its 2012 audit because the engagement was uneconomic.[63] The Fund's new management and its subsequent independent auditor (BDO) issued 2013 audited financial statements that did not restate the beginning balance of the partner's capital account, indicating neither believed the 2012 financial statements were materially misstated—a determination that is all the more noteworthy given that the GP had been removed and new management and BDO were well aware of the present allegations at the time they made that determination.

III. MR. BEAMISH CORRECTLY CONCLUDED THAT FUND III MANAGEMENT PREPARED ITS FINANCIAL STATEMENTS IN COMPLIANCE WITH GAAP

Each year, Fund III's General Partner, through its Management Company, prepared financial statements that were disseminated to the Fund's limited partners.[64] PwC audited these financial statements and provided an audit opinion providing that it had conducted its

[63] *See* Ex. 1181 [Beamish Dep.] at 63:12-21.
[64] Ex. 1187 [Sen Dep.] at 73:25-75:11.

audit in accordance with Generally Accepted Auditing Standards ("GAAS"), and that the financial statements were fairly presented, in all material respects.[65]

The Division's entire case essentially boils down to the purportedly unauthorized payments from the Fund to its General Partner. Yet the Division cannot avoid the fact those payments were repeatedly and accurately disclosed to the Fund's investors. Each year, the financial statements reported the Relevant Transfers as prepaid expenses paid to the General Partner (or its management company) on the balance sheet,[66] in the statement of cash flows,[67] and in the accompanying financial statement footnote disclosures explaining that the prepaid expenses represented a receivable owed to the Fund by its General Partner, a related party.[68] The Division does not challenge the accuracy of the fee calculation, but rather nitpicks solely with the language used to describe the Relevant Transfers that were unequivocally identified as related-party payments. Yet as Mr. Holder, Mr. Goolsby, and Mr. Riley will all testify, the reporting and disclosure of the Relevant Transfers were in compliance with GAAP, and thus the Division has no basis to contend that Mr. Beamish engaged in improper professional conduct.[69]

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[65] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20030; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 35995; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43397; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at Report of Independent Auditors.

[66] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20031; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 25996; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43398; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 2.

[67] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20038; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36003; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43406; Ex. 1004 [Fund III, L.P. 2009 Financial Statements] at p. 10.

[68] Ex. 1001 [Fund III, L.P. 2012 Financial Statements] at PWC 20046; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36012; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43415; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 20.

[69] Ex. 1131 [Holder Rep.] at ¶¶ 11, 54-78; Ex. 1130 [Riley Rep.] at ¶¶ 30, 54; Ex. 1133 [Goolsby Rep.] at ¶¶ 9, 99-103.

A. GAAP Delineates the Standards to which Auditors Must Hold Financial Statements

1. Auditors Must Apply Significant Professional Judgement In Evaluating Management's Application of GAAP.

An auditor must apply professional judgement in obtaining reasonable assurances that the financial statements are free from material misstatement.[70] Financial statements are not discursive descriptions of a company's economic state, but are instead based on the auditor's judgments.[71] An auditor must apply his professional judgement to interpret the guidance set forth in GAAP, evaluate whether information is material to the users of the financial statements, and express an opinion that the financial statements conform with GAAP.[72] Consequently, similarly situated auditors may apply their professional judgment and reach different conclusions regarding the appropriate disclosures while both still obtaining reasonable assurances that the financial statements are free of material misstatements.[73]

An auditor's application of professional judgment is evaluated "based on whether the judgment reached reflects a competent application of auditing standards and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report."[74] In applying his professional judgement, "the auditor should evaluate whether, in view of the requirements of the applicable financial reporting framework . . . the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements."[75]

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[70] Ex. 1155 [AU 230.11].

[71] Ex. 1131 [Holder Rep.] at ¶ 25; CON 8, ¶ OB11.

[72] *See* CON 8, ¶ OB11; CON 8, ¶ BC3.4; CON 2 ¶ 7; Ex. 1176 [ASC 105-10-05-6]; CON 8, ¶QC11; CON 2 ¶132; Ex. 1179 [AU 410.01, 410.02].

[73] *See* Ex. 1131 [Holder Rep.] at ¶ 31; Ex. 1133 [Goolsby Rep.] at ¶ 90.

[74] Ex. 1157 [AU-C 200.A30].

[75] Ex. 1172 [AU-C 700.16e]. *See also* Ex. 1152 [AU-C 320.04] ("[t]he auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements.").

2. GAAP is a Set of Accounting Principles that Allows for Variation in Financial Statements.

Because GAAP "frequently provides broad principles rather that specific rules, instructions, or procedures"[76] regarding how events should be disclosed, management must choose one of several alternative accounting and/or reporting treatments—each of which could result in different but appropriate disclosures.[77] Applying his professional judgment, an auditor must therefore ask not whether more information could have been disclosed (which is always the case), but rather whether management's disclosure provided necessary and useful information to financial statement users deciding how to allocate their resources.[78]

3. Financial Statements Must Be Read as a Whole.

In providing users with necessary information, financial statements and the accompanying notes are inherently interrelated. Each presents different aspects of the same transactions or other events affecting an entity, and none is likely to provide all the financial statement information that is useful for a particular kind of assessment or decision.[79]

To that end, when assessing the disclosure of a specific transaction, an auditor must look to whether the financial statements as a whole adequately describe the transaction, not whether any individual footnote or piece of the financial statements read in isolation is sufficient.[80] *Cf. In re WorldCom, Inc. Sec. Litig.*, 352 F.Supp.2d 472, 479–80 (S.D.N.Y. 2005) ("When an auditor represents that a company's financial statements conform, in all material respects, with GAAP, the auditor 'indicates [his] belief that the financial statements *taken as a whole* are not materially misstated.'") (emphasis in original) (citing AU 312.03).

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[76] Ex. 1131 [Holder Rep.] at ¶ 27.
[77] *See Id.*
[78] CON 8, ¶ OB11. As such, evaluating whether financial statements are presented fairly in conformity with GAAP must be based on the requirements set forth therein, not speculation about what additional information a hypothetical investor might benefit from knowing.
[79] Ex. 1132 [Holder Rebuttal Rep.] at ¶ 17.
[80] Ex. 1164 [ASC 850-10-50-1].

B. The Fund III Financial Statements Complied with GAAP's Requirements for Related Party Transaction Disclosures.

As described above, each year the Fund III financial statements accurately calculated the Relevant Transfers and disclosed them as related-party payments from Fund III to its General Partner (or the General Partner's management company).

Fund III's related-party transaction disclosures must conform with two requirements: ASC 850 and ASC 946.[81] ASC 850 sets out the requirements for related-party disclosures generally and ASC 946 includes comparable guidance for investment companies like Fund III.

The objective of GAAP's related-party disclosure requirements is to ensure that "information about transactions with related parties that would make a difference in decision making shall be disclosed so that users of the financial statements can evaluate their significance."[82] Specifically, financial statements must disclose:

> a. The nature of the relationship(s) involved
>
> b. A description of the transactions . . . for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements
>
> c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
>
> d. Amounts due from or to related parties as of the date of each balance sheet presented and, *if not otherwise apparent*, the terms and manner of settlement.[83]

ASC 850 does not specify the level of detail of those disclosures, which varies "based on the nature and complexity" of the transaction as well as the "information disclosed elsewhere in

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[81] The OIP alleges only violations of ASC 850; OIP ¶ 26, 27, 32, 33. However, the government's expert, Mr. Devor, states opinions about the Fund III financials' compliance with ASC 946. *See,* Ex. 300 [Devor Rep.] at ¶ 62.

[82] Ex. 1164 [ASC 850-10-10-1].

[83] *Id.*

the financial statements regarding those transactions."[84] Thus, the disclosures must be measured using the totality of the information available to users.

Here, the disclosures at issue met each of the requirements provided by ASC 850 and ASC 946, providing all of the information that would make a difference in the decision-making of the users of the financial statements.[85]

1. The Nature of the Relationship Between the Fund and the Recipient of the Payments was Plainly Disclosed

There is no dispute that the financial statements plainly disclosed the related-party relationship. From 2009-2011, the Related Party footnote explained that the Relevant Transfers were made to the General Partner.[86] The General Partner is defined within the financial statements[87] (and, of course, is well known to the limited partners through their execution of the LPA, an agreement they entered into with the General Partner). In 2012, the Related Party footnote explained that the Relevant Transfers were owed by Burrill Capital, LLC, defined therein as "the management company of the General Partner."[88]

2. The Financial Statements Adequately Described the Relevant Transfers.

Taken as a whole, the financial statements conveyed all of the material facts and circumstances of the related-party transaction at issue here such that "users of the financial statements can evaluate their significance." ASC 850-10-10-1.

As explained above in Section III.A.1, an auditor must apply substantial professional judgment in determining what information is apparent from disclosures already included

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[84] Ex. 1131 [Holder Rep.] at ¶ 39.

[85] The Division does not appear to dispute that the financial statements adequately disclosed both the (1) nature of the relationship involved (*e.g.* a transaction between the Fund and the General Partner) and (3) the dollar amount of the transactions.

[86] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20046; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36102; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43415.

[87] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20039; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36004; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43407; Ex. 1004 Fund III, L.P. 2012 Financial Statements] at p. 11.

[88] Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 20.

elsewhere in the financial statements and related-party notes and what additional information, if any, is necessary to understanding related-party transactions.[89] That professional judgment includes both (1) "consideration of the nature and complexity of the transactions" and (2) "knowledge of the users of the financial statements."[90]

Here, the Relevant Transfers were not complex or difficult to understand—they were prepaid expenses paid to the Fund's General Partner. Management fees are a routine and simple transaction typical of venture capital funds and were described in the LPA—a contract that all of the users of the financial statements signed. Prepayment of fees between parties who have a contractual obligation is also a simple concept.

Each year, the financial statements properly recorded the Relevant Transfers as a prepaid expense in multiple places throughout the financial statements. Mr. Beamish will present expert testimony from three experts—Mr. Holder, Mr. Gooslby and Mr. Riley – that the Relevant Transfers were appropriately characterized as either a prepaid expense or a receivable.[91]

The term "receivable" is not defined in GAAP and is a very broad asset designation applicable to all debts, unsettled transactions, or other obligations owed to a company.[92] Thus, management fees advanced by the Fund that resulted in the Fund having a right to receive settlement in future services or other compensation were appropriately characterized as a receivable.[93]

89 Ex. 1131 [Holder Rep.] at ¶ 48.
90 *Id.*
91 Ex. 1196 [Holder Dep.] at ¶¶ 94:7-95:8, 115:4-10, 122:14-123:6, 132:25-133:13; Ex. 1195 [Goolsby Dep.] at ¶¶ 195:17-196:16, 289:7-290:19; Ex. 1194 [Riley Dep.] at 125:9-21.
92 Ex. 1131 [Holder Rep.] at ¶ 52; Ex. 1196 [Holder Dep.] at 132:24-133:13.
93 Ex. 1132 [Holder Rebuttal Rep.] at ¶ 7-9; [Holder Dep.] at 94:7-95:8, 115:4-10; Ex. 1194 [Riley Dep.] at 125:9-21.

The term "prepaid expense" simply refers to consideration that is advanced prior to the recognition of an expense.[94] Therefore, it was entirely appropriate to describe management fees that the Fund advanced to the General Partner prior to those management services being rendered as a "prepaid expense."

Neither prepayments nor receivables are difficult accounting concepts. Further, because both prepaid expenses and receivables share many of the same attributes, it is not misleading or confusing to describe the asset as both.[95] The important information that these terms convey to readers of the financial statements is that the reporting entity has an asset on its books from another entity.[96]

Nor were the Relevant Transactions buried in lengthy, complex financial statements. To the contrary, they were highly visible and understandable. For example, the 2009 Fund III balance sheet—the first page of the financial statement (following the PwC opinion)—identifies only *three* significant Fund assets: securities investments, cash, and prepaid expenses.[97] Notably, the very magnitude of the prepaid expenses emphasized by the Division makes the payments highly visible throughout the Fund's financial statements. In fact, in 2010, 2011, and 2012, the prepaid expenses and other receivables line item on the Fund's balance sheet represented the single largest asset of the Fund aside from its securities investments.[98]

The reporting of the Relevant Transactions as prepaid expenses on the balance sheet and in the cash flow statement was further expanded upon in the Related Party footnote. The Related Party footnote made it abundantly clear that, throughout the relevant period, the

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[94] Ex. 1131 [Holder Rep.] at ¶ 63 (citing Jan R. Williams, Keith G. Stanga, and William W. Holder, Intermediate Accounting 944 (2nd ed. 1987) ("Prepaid expenses. Expenses for which cash has been paid but benefit has not been received.")).

[95] Ex. 1131 [Holder Rep.] at ¶¶ 52, 63; Ex. 1132 [Holder Rebuttal Rep.] at ¶¶ 7, 8 9; Ex. 1196 [Holder Dep.] at 94:7-95:8, 115:4-10, 122:14-123:6, 132:25-133:13.

[96] Ex. 1194 [Riley Dep.] at 129:16-20, 131:5-21; Ex. 1196 [Holder Dep.] at 145:11-146:10.

[97] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20031.

[98] Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 35996; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43398; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 2.

General Partner was receiving prepayments from the Fund. In each year, the Related Party footnote stated that the "prepaid expenses" for that year included "a receivable from the General Partner."[99] Each year that footnote accurately and separately stated the balance receivable from the General Partner.[100] The financial statements' Statement of Operations reported only a single annual expense of any significance—the management fee—making it self-evident that the only expense which could have been prepaid was the management fee.[101] These disclosures were not hidden or difficult to piece together. Each year the financial statements contained fewer than ten notes.

Second, the financial statements provided more than sufficient information about the nature of the Relevant Transactions given the knowledge of the users here. Generally, GAAP assumes that financial statement reports are prepared for users who have "an appropriate knowledge of business and economic activities and accounting"[102] and who are "responsible for studying reported financial information with diligence."[103] Fund III's limited partners were knowledgeable and experienced investors with significant access to the Fund's management, accountants, and books and records.[104]

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[99] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20046; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36012; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43415; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 20.

[100] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20046; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36012; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43415; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 20.

[101] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20036; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36001; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43404; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at p. 8.

[102] Ex. 1145 [AU 312.06] (It is reasonable for auditors to assume that users of the financial statements have "an appropriate knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with an appropriate diligence.").

[103] Ex. 1131 [Holder Rep.] at ¶ 34; CON 8, ¶ BC3.43 ("To clarify another frequently misunderstood point, the Conceptual Framework explains that users are responsible for actually studying reported financial information with reasonable diligence rather than only being willing to do so (which was the statement in the previous frameworks)"); *see also* CON 1, ¶34; CON 2, ¶40.

[104] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00617 ("7.4 Accredited Investor and Investment Company Act Representations. Each Limited Partner represents that such Partner has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Partnership and that such Partner is an accredited investor, as that term is defined in Regulation D, promulgated by the Securities and Exchange Commission (the 'SEC').").

The Division acknowledges that the Fund's investors were sophisticated institutional investors, many of which, as managers of pension funds or funds-of-funds, had fiduciary duties to their own investors to be familiar with the Fund's financial performance.[105] Indeed, the LPA, at Section 7.4, included an express representation that all investors were accredited and had "such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Partnership."[106]

The LPs received hard copies of and had electronic access to the Fund's audited financial statements. They attended annual meetings at which the Fund's financial performance was discussed and had access to Mr. Burrill and Mr. Hebert (and other GP members) for any questions they may have had about the Fund's finances. The LPs also had the right, under Section 9.3 of the LPA, to inspect the Fund's books and records, and to be given access to the Fund's auditors and accountants to discuss the Fund's finances.[107] Additionally, the Fund had a limited partner advisory committee composed of the top five investors in the Fund, who were responsible (under Section 7.11 of the LPA) for reviewing and approving the fair market value of the Fund's assets and could thus reasonably be assumed to be carefully reviewing the Fund's balance sheet each year.[108]

The LPs were sophisticated, had complete access to underlying financial data and to management (as well as to PwC) had they chosen to request it, and had each invested millions (or tens of millions) of dollars in the Fund, providing significant incentive to understand one of the largest (and growing) line items in the financial statements.

[105] OIP at ¶ 11.
[106] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00617-618.
[107] *Id.* at PWC 00633-634.
[108] *Id.* at PWC 00623-625.

3. **The Financial Statements Properly Reflected The Dollar Amounts of the Relevant Transactions.**

The Division does not dispute that in each of the relevant years the Related Party footnote accurately reported the amounts transferred to the General Partner. The financial statements clearly and unequivocally informed investors that the Fund had paid millions of dollars of prepaid expenses (set out as a separate line item on the Statement of Cash Flows) *and* that the outstanding balance of prepaid expenses had increased each year (set out as a separate line item on the balance sheet).

4. **The Terms or Manner of Settlement Were Apparent or Disclosed.**

Finally, ASC 850-10-05-1 only requires disclosure of the terms and manner of settlement "*if not otherwise apparent.*"(Emphasis added).

Here, the terms and manner of settlement were apparent from the disclosures in the financial statements.[109] As described above, the notes to the financial statements from 2009-2011 disclosed that the General Partner received an annual management fee for its services[110] and that the Fund had made prepayments to the General Partner.[111] Since the financial statements plainly described the Relevant Transfers as a prepaid expense owed by the General Partner, consistent with the concepts underlying GAAP, the manner of settlement would naturally occur through the provision of the services being prepaid. In other words, it was apparent from the very nature of the transaction and the widely understood term "prepaid expense" that the General Partner would settle the receivable over time through the provision

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[109] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20028; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 35993; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43395; Ex. 1004 [Fund III, L.P. 2012 Financial Statements].

[110] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20036, PWC 20045-46; Ex. 1002 [2010 FS] at PWC 36001, PWC 36011; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43404, PWC 43414-15; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at pp. 8, 19.

[111] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20031, PWC 20038, PWC 20046; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 35996, PWC 36003, PWC 36012; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43398, PWC 43406, PWC 43415; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at pp. 2, 10, 20.

of future management services, and contrary to the Division's claim did not require additional disclosure.[112]

In fiscal year 2012, when Mr. Beamish determined that the Relevant Transfers had exceeded future management fees, and thus the balance would need to be repaid from sources other than the provision of future management services, Fund III's management, at PwC's urging, added further disclosures. Management revised the Related Party footnote to explain that the prepaid expenses would be resolved through a combination of future services and cash.[113] The 2012 Related Party footnote provided details regarding the manner of settlement, specifying that it was a receivable from the "the Management Company [which] intends to pay this amount to the Partnership from future distributions to the General Partner and from Management Company funds."[114] Thus, when the manner of settlement was no longer apparent, Mr. Beamish took appropriate steps to prompt management to include the proper disclosures.

C. The Division's Challenges to the Disclosures Are Meritless.

Faced with the irrefutable fact that Fund III's financial statements repeatedly disclosed all material information, the Division resorts to second-guessing their particular wording or the placement of disclosures in the easily read, 20-page financial statements. As described further below, these criticisms stem from piecemeal readings of the financial statements, unsupported legal interpretations of the LPA, and a fundamental misunderstanding of the concepts that underlie GAAP.

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[112] Ex. 1131 [Holder Rep.] at ¶¶ 65, 76; Ex. 1194 [Riley Dep.] at 139:9-18; Ex. 1196 [Holder Dep.] at 163:21-164:19.

[113] 1004 [Fund III, L.P. 2012 Financial Statements] at p. 20.

[114] *Id.*

1. The Financial Statements Adequately Described the Relevant Transfers.

The Division alleges that the Fund's financial statements do not adequately "describe the transaction" as required by GAAP because the footnotes to the financial statements were not sufficiently detailed.[115] More specifically, the Division's expert, Mr. Devor (who was paid to help the Division develop its case against Mr. Beamish), opines that the Fund's financial statements were materially misstated because they:

> (1) described the prepaid management fees as "prepaid expenses" or as a "receivable from the General Partner" rather than an "expense";[116]
>
> (2) "failed to reflect the proper carrying value" of the prepaid management fees, since the amounts should have been offset to reflect their non-collectability;[117]
>
> (3) failed to "sufficiently explain" the relationship between the prepaid expense line item on the balance sheet, the management fees as described in the Management Fee footnote, and the receivable from the General Partner in the Related Parties footnote;[118] and
>
> (4) "contained no explanation of the business purpose of the related party receivable."[119]

As explained below, each of these contentions is without merit.

a) The Relevant Transfers Were Properly Recorded as a "Prepaid Expense" or "Receivable."

Mr. Devor's opinion that it was improper to describe the Relevant Transfers as either a prepaid expense or receivable are based upon overly narrow and unsupported interpretations of those terms.

First, Mr. Devor asserts that it was improper to call the Relevant Transfers prepaid expenses in certain years because ASC 340-10-15 states that prepaid expenses are "typically" utilized "within the normal operating cycle of an entity," which is generally one year.[120]

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[115] OIP at ¶ 33, 38.
[116] Ex. 300 [Devor Rep.] at ¶¶ 110, 119, 124, 165, 172, 190, 218, 222, 300.
[117] *Id.* at ¶ 66; *see also* ¶¶ 70, 309.
[118] *Id.* at ¶¶ 67, 68, 110, 119, 165, 218, 300.
[119] *Id.* at ¶¶ 170; 308.
[120] *Id.* at ¶¶ 53, 54.

Critically, ASC 340-10-5 merely states that prepaid expenses are "typically" utilized within the normal operating cycle, not that an asset *must* be utilized within one year to be classified as a prepaid expense.[121] Moreover, Mr. Devor's analysis reflects a fundamental lack of understanding as to how financial institutions such as the Fund operate. Because such funds do not exhibit normal operating cycles, they are not required to and generally do not distinguish between current assets and long-term assets on their balance sheets.[122]

Similarly, Mr. Devor's argument, that it was improper to call the Relevant Transfers a "receivable" because that term only applies to assets expected to be realized through the receipt of cash,[123] is inconsistent with GAAP. GAAP does not mandate that receivables must be settled in cash.[124] In fact, ASC 310, to which Mr. Devor cites, clearly indicates that receivables may be satisfied or realized through the receipt of consideration other than cash such as real estate, shares of stock, or other assets.[125]

Mr. Devor's opinion that the Relevant Transfers "more accurately constituted improper withdrawal of Fund assets" and therefore should have been recorded as an "expense" rather than an asset derives from his apparent legal conclusion that the payments were "*in fact* . . . made in violation of the Partnership Agreement."[126] But Mr. Devor, an accountant, has *no* qualification to assert that the prepayment of fees violated the LPA. As discussed further below in Section IV.B.3.a., the LPA itself was silent on whether fees could be prepaid, and the entire management team empowered by the Fund to manage its operations—including the management company's chief legal officer--represented to the audit team that the prepayments were authorized. As Mr. Devor's assertion that the Relevant

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[121] ASC 340-10-5.
[122] Ex. 1132 [Holder Rebuttal Rep.] at ¶ 13.
[123] Ex. 300 [Devor Rep.] at ¶ 190.
[124] Ex. 1132 [Holder Rebuttal Rep.] at ¶ 7.
[125] Ex. 300 [Devor Rep.] at ¶ 55; Ex. 1162 [ASC 310-40-40-2] ("A creditor that receives from a debtor in full satisfaction of a receivable either or both of the following shall account for those assets (including an equity interest) at their fair value at the time of the restructuring: a. Receivables from third parties, real estate, or other assets. b. Shares of stock or other evidence of an equity interest in the debtor.").
[126] Ex. 300 [Devor Rep.] at ¶ 67 (emphasis added), *see also* ¶¶ 68, 302, 307, 308.

Transfers should have been recorded as an expense rather than an asset is based on an incorrect premise, which he is unqualified to assert, his conclusion has no merit.[127] His conclusion is also contradicted by new management and the successor independent auditors.

Similarly, Mr. Devor's assertion that the financial statements do not disclose that the Relevant Transfers are a prepayment of management fees because the financial statements do not use the words "prepaid management fees" is based on an improper piecemeal reading of the financial statements. Mr. Holder, Mr. Riley and Mr. Goolsby all agree that although the financial statements did not use the words "prepaid management fee," a user of the financial statement, reading the statements *as a whole*, would reasonably understand that the prepaid expenses to the General Partner *must* have related to prepaid management fees since that was the *only/primary* service the General Partner provided to the Fund.[128] If for some reason a Limited Partner reviewing the financial statement was unclear as to what the several million dollars in prepaid expenses paid to the General Partner that year were, and why the size of the receivable was increasing, that user was equipped with *all* of the information necessary to inquire further of management.

b) The Financial Statements Properly Calculated the Relevant Transfers

Mr. Devor does not contest that the financial statements accurately reflected the total amount of the Relevant Transfers to the General Partner, but nonetheless contends that the recorded balance was incorrect because it should have been offset to reflect amounts that were not collectable.[129] Again, Mr. Devor's conclusion rests on incorrect premises and faulty interpretations of GAAP. Under GAAP, assets are only "subject to a valuation allowance (i.e. reduction in value) if information available before the financial statements are issued

[127] Ex. 1132 [Holder Rebuttal Rep.] at ¶¶ 27-31.
[128] Ex. 1196 [Holder Dep.] at 146:15-147:1, 163:21-164:19; Ex. 1195 [Goolsby Dep.] at 116:5-117:20, 211:11-24; Ex. 1194 [Riley Dep.] at 133:16-134, 135:20, 152:3-153:2.
[129] Ex. 300 [Devor Rep.] at ¶¶ 66, 70, 309, 312.

'indicates that it is *probable* that an asset has been impaired at the date of the financial statements,' and 'the amount of the loss can be reasonably estimated.'"[130] Further, the "term probable is generally considered to equate to approximately 75% likelihood."[131] Thus, the "offset" that Mr. Devor claims PwC should have applied[132] would only been appropriate if "Fund III's management and Mr. Beamish concluded that: a) it was 'likely' (i.e., approximately a 75% or more likelihood) that the fund would not recover its asset; and b) the amount of shortfall could be reasonably estimated."[133] As explained below, Mr. Beamish and his teams obtained adequate audit evidence during each of the relevant years regarding the collectability of the transfers, and therefore the offset Mr. Devor suggests would have been inappropriate.[134]

c) **Mr. Devor's critiques regarding the sufficiency of the footnote disclosures merely reflect his failure to read the financial statements as a whole.**

Mr. Devor opines that the financial statements were misleading because the management fee footnote, related party footnote, and prepaid expense line item on the

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130 Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 34 (citing "ASC 310-10-35-07 and 08").

131 *Id.*

132 Ex. 300 [Devor Rep.] at ¶¶ 56, 66, 70, 309, 312.

133 Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 34.

134 The audit team received a signed written management representation that "[r]eceivables recorded in the financial statements represent bona fide claims against debtors, for transactions arising on or before the balance sheet date. No losses are expected to be sustained on realization of the receivables." Ex. 1099 [2009 Management Representation Letter] at PWC 32028. There was similar language in subsequent years. Ex. 1009 [2012 Management Representation Letter] at PWC 34435; Ex. 1049 [2011 Management Representation Letter] at PWC 33620; Ex. 1075 [2010 Management Representation Letter] at PWC 32782. The audit teams also performed risk assessment procedures with respect to Prepaid Expenses / Receivables and developed specific tailored procedures to address the respective risks. One such procedure is documented as "recompute amounts expensed for the year (i.e. amortization) and compare amounts expensed or written off with income statement accounts." Ex. 1104 [2009 Prepaid Expense Analysis Workpaper]; Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 19336, Ex. 1065 [2011 Future Management Fee Calculation Workpaper], Ex. 1028 [2012 Prepaid Expense Workpaper]. As the Prepaid Expenses / Receivables balance grew in 2011 and 2012 the engagement teams performed an additional procedure to test the recoverability of the balance by scheduling out expected future management fees and comparing that estimate to the year-end asset balance. Ex. 1065 [2011 Future Management Fee Calculation Workpaper]; Ex. 1028 (2012). The 2012 engagement team obtained evidence with regard to the General Partner's and the management company's intent to reimburse the Fund. For example, in the management representation letter, Ex. 1075 [2010 Management Representation Letter], and in conversations with the management team documented in the workpapers. Ex. 1028 [Future Management fee Calculation] at PWC 27630.

balance sheet did not contain cross-references to each other.[135] However, GAAP does not require such cross-referencing.[136] What GAAP *does* require is that users read the financial statements as a whole—something Mr. Devor simply does not do.

The Management Fee footnote accurately disclosed the management fee earned during the fiscal year. The prepayment of future fees, properly treated as an asset due to a related party rather than a current year expense,[137] is separately disclosed in the Related Party footnote appearing immediately after (or two footnotes after) the Management Fee disclosure. The Division cites no authority under GAAP requiring some sort of cross-reference between provisions separated by at most a few lines in a short financial statement containing only 8-9 footnotes.

d) GAAP Does Not Require Disclosure of the Business Purpose of Related Party Transactions.

Mr. Devor opines that the financial statements were somehow deficient because they did not disclose the business purpose of the transaction.[138] Mr. Devor appears to conflate the GAAS standards requiring an auditor to adequately understand the business purpose with a non-existent GAAP disclosure requirement.[139] ASC 850-10-50 simply does not require disclosure regarding the "business purpose" of a related-party transaction.[140]

e) The Terms or Manner of Settlement Were Apparent or Disclosed.

The Division also alleges that the financial statements for years 2009-2011 were deficient because they failed to describe the "terms and manner of settlement" as required by ASC 850-10-05-1.[141] However, ASC 850-10-05-1 only requires disclosure of the terms and

[135] Ex. 300 [Devor Rep.] at ¶¶ 110, 120, 159, 162-163, 165, 169, 218, 276, 300.
[136] *See* Ex. 1164 [ASC 850]; Ex. 1160 [ASC 946].
[137] Ex. 1132 [Holder Rebuttal Rep.] at ¶¶ 27-31.
[138] Ex. 300 [Devor Rep.] at ¶¶ 170, 308.
[139] Mr. Devor's critique appears to be limited to 2010 and 2012. Ex. 300 [Devor Rep.] at ¶¶ 170, 308.
[140] Ex. 1164 [ASC 850-10-50-1].
[141] OIP at ¶ 27, 33; Ex. 300 [Devor Rep.] at ¶¶ 107, 110, 165, 218, 300.

manner of settlement "*if not otherwise apparent*." (emphasis added) Both Mr. Devor's report and the OIP oddly omit that relevant portion of the requirement.

For the reasons described above, from 2009-2011 the manner of settlement was apparent from the very nature of the transaction—a prepayment for future management services—and new disclosures regarding the manner of settlement were added in 2012 as the circumstances changed. Mr. Devor concedes that 2012 financial statements contained a "meaningful discussion of the receivable,"[142] but nonetheless criticizes these absence of "a timeframe for resolution of the receivable" or "a provision for associated interest."[143] But no such timeframe or interest rate had been established, and Mr. Devor does not cite any authority for his contention that terms that did not exist must somehow nonetheless be disclosed.[144]

D. The Relevant Transfers Were Separately Shown in Accordance with GAAP.

As a separate issue, the Division alleges that the financial statements did not comply with GAAP because they included "the amount of advanced management fees as an unidentified part of a larger amount of prepaid expenses and other receivables,' but did not separately show a related party receivable on the balance sheet" as required by ASC 850-10-50-2 and ASC 946-310-45-1.[145]

However, the Division's argument is based upon a deceptively edited and inaccurate description of GAAP. Although the Division is correct that both ASC 850-10-50-2 and ASC 946-310-45-1 indicate that receivables from related parties must be shown separately, *neither* indicate *where* separate disclosure must be made.

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[142] Ex. 300 [Devor Rep.] at ¶ 107.
[143] *Id.* at ¶ 275.
[144] Ex. 1194 [Riley Dep.] at 148:12-149:20, 162:14-24.
[145] OIP ¶¶ 27, 32; Ex. 300 [Devor Rep.] at ¶¶ 69, 110, 116, 165, 218, 310.

ASC 850-10-50-2 merely requires that accounts receivable from related-parties be shown "separately and not included under a general heading such as notes receivable or accounts receivable." ASC 850-10-50-2 does *not* require that each related-party balance be separately itemized *on the balance sheet* (as opposed to the footnotes).[146] Similarly, ASC 946-310-45-1, which applies to Investment Companies like Fund III, merely states that "receivables from related parties" must be "listed separately" but does not specify where. When GAAP requires disclosure on the balance sheet, that requirement is stated. For example, "[i]n other situations, such as the presentation of earnings per share, GAAP specifies where an entity should make the disclosure, stating that entities 'shall present basic per-share amounts for income from continuing operations and for net income on the face of the income statement.'"[147]

In fact, a different section of ASC 946, which Mr. Devor fails to address in his report, specifically provides that "[d]etails of related-party balances and other assets and labilities shall be presented in the statement of net assets *or in the notes of the financial statements.*" ASC 946-210-45-2 (emphasis added).[148] Thus, GAAP explicitly provides two alternative approaches to disclosing that information for Fund III—either in the statement of net assets *or* the notes to the financial statements.[149]

It appears that the Division is inappropriately applying a requirement from Regulation S-X,[150] which is not applicable to Fund III since Fund III was not required to and did not file its financial statements with the Commission.

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[146] Ex. 1164 [ASC 850-10-50-2].
[147] Ex. 1131 [Holder Rep.] at ¶ 53 (Ex. 1177 [ASC 260-10-45-2]).
[148] Ex. 1160 [ASC 946-210-45-2].
[149] Ex. 1160 [ASC 946-210-45-2].
[150] Regulation S-X states that "[r]elated party transactions should be identified and the amounts stated on the face of the balance sheet, income statements, or statement of cash flows." 17 C.F.R. § 210.4–08(k)(1); Ex. 1133 [Goolsby Rep.] at ¶ 20.

Here, Fund III's 2009-2012 related party footnotes consistently and separately stated the amount receivable from the related party, something that the Division does not contest.[151] Fund III was not required to replicate this disclosure on its balance sheet.[152]

IV. MR. BEAMISH COMPLIED WITH GAAS IN THE AUDITS OF FUND III

Pursuant to AU 110.03, "[t]he auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud."[153] As discussed above in Section III.B., GAAP defines whether financial statements contain a material misstatement. GAAS outlines the procedures related to planning and performing the audit that an auditor should follow or consider following to determine in evaluating whether the financial statements read as a whole are fairly presented in all material respects.[154]

Where, as here, the financial statements include repeated disclosures of the transfers at issue, and contain no material misstatements, the Division's Monday-morning quarterbacking of the audits is particularly unwarranted.[155] Regardless, there is no credible argument that Mr. Beamish's audits were not performed in accordance with GAAS.

To the contrary, the lack of material misstatement in the Fund III financial statements was in fact the result of the diligent audit that Mr. Beamish and his team appropriately performed each year—assessing risks, testing controls, testing transactions, and evaluating the adequacy of the financial statement disclosures. The Division does not argue that the financial statements contained any calculation errors or omitted material transactions.

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[151] OIP ¶ 18, 30

[152] Ex. 1133 [Goolsby Rep.] at ¶ 20 ("ASC 850-10-50-2 states that '[n]otes or accounts receivable from officers, employees, or affiliated entities must be shown separately and not included under a general heading such as notes receivable or accounts receivable.' This does not require that the related party balance be shown separately on the balance sheet (as opposed to the footnotes). . . . it appears that the SEC Staff is applying a requirement from Regulation S-X, which is not applicable for Fund III.").

[153] Ex. 1163 [AU 110.03].

[154] *See generally* Ex. 1159 [AU 150].

[155] *See* Ex. 1130 [Riley Rep.] at ¶ 22 ("In my experience evaluating whether deficiencies in an audit require disciplinary or other enforcement action, such an action is almost never warranted when a transaction or other area of concern is explicitly disclosed in the financial statements.").

Instead, the Division's claims relating to GAAS violations essentially boil down to one central premise: that Mr. Beamish failed to determine that the payments of prepaid expenses were unauthorized and unrecoverable, and thus he should not have given a clean opinion stating that the financial statements were prepared in accordance with GAAP. The Division is wrong. Each year, Mr. Beamish took appropriate steps under GAAS to conclude that the Relevant Transfers were properly authorized by the General Partner management team responsible for managing Fund III, that the asset was recoverable given future management fees due to the General Partner as well as other capital available to the General Partner, and that the related party transaction was properly disclosed.

A. GAAS is a Standard of Audit Conduct, Not a Prescribed Set of Strict Rules.

GAAS provides guidance both on the mindset the auditor should adopt and the audit procedures that an auditor should consider following. In doing so, GAAS makes clear that auditors do not mechanically apply straightforward rules. They are professionals operating in complex settings, applying their professional judgment to provide their clients with a reasonable level of assurance.[156]

An auditor must exercise due professional care in planning and performing an audit, and in preparing the audit report.[157] Due care is defined as "the degree of skill commonly possessed by other auditors" and should be exercised with 'reasonable care and diligence.'"[158] "Due care" requires an auditor to exercise "professional skepticism" or "an attitude that includes a questioning mind and a critical assessment of audit evidence."[159] The auditor should gather and evaluate evidence objectively and in good faith, without assuming either

[156] *See generally* Ex. 1155 [AU 230].
[157] Ex. 1155 [AU 230.01].
[158] Ex. 1155 [AU 230.05].
[159] Ex. 1155 [AU 230.07].

that management is honest or dishonest.[160] In short, the auditor should be neutral, objective, and rigorous.

Auditors must provide *reasonable assurance* that the financial statements are free of material misstatement.[161] The auditor should have a reasonable basis for his opinion and should obtain sufficient evidence to form that basis.[162] However, because the information being audited is typically tested selectively, the auditor must exercise considerable professional judgment in selecting the areas to be tested, deciding which tests to perform and when, and evaluating the results.[163] Further, fraud perpetrated by management may prevent auditors from recognizing a material misstatement.[164] Thus, GAAS recognizes that "[a]bsolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud."[165] As a result, "the auditor is not an insurer," and he cannot guarantee the accuracy of his report.[166]

B. Mr. Beamish Properly Applied GAAS in his Audits of Fund III

In accordance with GAAS, Mr. Beamish was reasonable in his planning and execution of the Fund III audits. As described further below, the Division's allegations to the contrary are not supported by the relevant facts, GAAS, or real world considerations. The evidence will show that Mr. Beamish: properly staffed the audit with qualified professionals; analyzed the client's business and the relevant information to assess risk; and performed appropriate testing to determine that the client's relevant key controls were operating effectively. Further, Mr. Beamish appropriately considered the results of his team's testing and performed or directed additional procedures as he deemed necessary. At every step in

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[160] Ex. 1155 [AU 230.07-.09].
[161] Ex. 1155 [AU 230.10].
[162] Ex. 1155 [AU 230.11].
[163] *Id.*
[164] Ex. 1155 [AU 230.12].
[165] Ex. 1155 [AU 230.10].
[166] Ex. 1155 [AU 230.13].

the audit, Mr. Beamish exhibited professional skepticism and relied on his professional judgment to determine the appropriate audit steps.

1. Mr. Beamish appropriately staffed and planned the Relevant Audits

The PwC teams charged with auditing Fund III were unquestionably qualified to audit venture capital funds.[167] Mr. Beamish was the leader of the venture fund practice at arguably the world's most prestigious accounting firm's office in the heart of Silicon Valley, personally audited dozens, if not hundreds, of venture funds; he is and was an industry expert in auditing entities like Fund III. The managers, Messrs. Burger, Balsys, and Lan, all had experience and training in auditing venture funds. The remaining team members consisted of highly qualified PwC accounting professionals, many of whom had experience auditing venture capital clients, and received training specific to audits of venture capital funds.[168]

Beyond requiring appropriate experience, in planning an audit, GAAS instructs auditors to obtain an understanding of the entity under audit and its environment "including its internal controls, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures."[169] Mr. Beamish and his teams' understanding of Fund III and its environment made them well-situated to make these risk assessments and design appropriate procedures to address those risks.

Fund III was a long-time client of PwC and Mr. Beamish. Mr. Beamish audited Fund III in each year starting in 2006 and audited a significant number of other Burrill entities. (*See chart of audited entities,* above in Section II.B.1.). Through this work, Mr. Beamish

[167] Ex. 1133 [Goolsby Rep.] at ¶ 16. *See also* Ex. 1174 [AU 210.01] (requiring that auditors "have adequate technical training and proficiency to perform the audit.").

[168] Ex. 1037 [2012 Planned Overall Responses to Risks of Material Misstatement Workpaper] at PWC 27191; Ex. 1133 [Goolsby Rep.] at ¶ 33; Ex. 1182 [Beamish Test.] at 16-17, 18; Ex. 1186 [Burger Test.] at 12, 14, 21; Ex. 1185 [Balsys Test.] 13, 15.

[169] Ex. 1146 [AU 314.01].

became familiar with management, the General Partners, the Limited Partners, and the operations of Burrill and Fund III.[170] As reflected in the workpapers, as a result of this experience, Mr. Beamish understood:

- Fund III was a well-established and respected venture capital fund run by a highly experienced management team with an excellent reputation and sophisticated investors. The Fund's manager's CEO was a former Big Four audit partner, its chief legal officer was a former managing partner of a prestigious law firm, and it had a controller and accounting manager who were respected among the management and General Partners.[171] In addition to management's reputational integrity, management had always demonstrated openness and cooperation with PwC audits.

- The structure of Fund III was similar to other Burrill funds and other funds in the venture capital industry.[172]

- Fund III actively sought to mitigate a major source of risk in venture funds by hiring—on Mr. Beamish's recommendation—a well-reputed outside valuation firm. The valuation of the Fund's investments directly impacted over 80% of the Fund's reported assets, were highly complex and reliant on subjective inferences that were susceptible to manipulation, and had a significant impact on the General Partner's own capital account allocation.[173]

- The LPA governed much of the Fund's activities, including the payment of management fees.[174]

- There were internal controls in place to govern the authorization of Fund III's cash disbursements and bank reconciliations. Beginning in 2010, two members of the GP were appointed to oversee and supervise the expense claims made by the personnel of Burrill and Company.[175]

- The Fund's sophisticated Limited Partners, as well as non-management members of the General Partner, were regularly provided information on the financial well-being of the Fund, which included information on the prepaid expenses. These

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[170] *E.g.* Ex. 1111 [2009 Fraud Risk Assessment Memo] at PWC 05867 (noting that the "tone at the top is properly set and management appears to be concerned with the proper valuation of investments, rather than trying to set unrealistic expectations about the Fund's performance."). The Fund III audit team also had continuity in team members. Mr. Burger acted as the senior manager in the 2009 through 2011 audits. Mr. Balsys and Mr. Lan acted as co-managers in the 2012 audit.

[171] Ex. 1017 [2012 Understanding of the Entity and Its Environment Workpaper] at PWC 27058-59.

[172] Ex. 1133 [Goolsby Rep.] at ¶ 35

[173] *See e.g.*, Ex. 1126 [Library Procedures Workpaper] at PWC 06552 (2009); Ex. 1277 [Valuation Specialist Completion Memorandum] at PWC 28907 (2012).

[174] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00610.

[175] *E.g.*, Ex. 1093 [2010 Fraud Risk Agenda Workpaper] at PWC 15934 (2010); Ex. 1066 [2011 Fraud Risk Agenda Workpaper] at PWC 22693 (2011) and Ex. 1029 [2012 Risks of Material Misstatement Due to Fraud or Error Workpaper] at PWC 28441 (2012).

investors were provided quarterly with unaudited financial statements and annually with audited financial statements, in accordance with the LPA.[176]

This knowledge of Fund III and its environment was instrumental to Mr. Beamish as he assessed the risk of material misstatement and designed appropriate procedures in accordance with those risks.

2. Mr. Beamish appropriately assessed the risk of fraud relating to the Relevant Transfers.

As part of this general consideration of risks, Mr. Beamish identified significant risks that would require special audit consideration.[177] This was a systematic process: Mr. Beamish evaluated the information presented by management, used his professional judgment to make determinations about what information would be significant for the fair reporting of financial statements, and determined which audit areas presented the greatest risk of a material misstatement.[178] After considering all relevant information, Mr. Beamish determined that the Relevant Transfers did not pose a significant risk of material misstatement.

Based on his significant knowledge of Fund III, its environment, and his knowledge of GAAS, Mr. Beamish determined that significant risks for Fund III included: management override of controls; investment valuations; partnership allocations; and, in 2011 and 2012, improper revenue recognition.[179] In Mr. Beamish's professional judgment, he understood these audit areas to be sufficiently complex and dependent on significant estimates made by management to warrant specific additional audit procedures.[180] Notably, the Division does

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[176] Ex. 1133 [Goolsby Rep.] at ¶ 35.

[177] *See* Ex. 1146 [AU 3114.110].

[178] *See generally* Ex. 1145 [AU 312]. GAAS make clear that the determination of significant risks "is a matter for the auditor's professional judgment." *Id.* atAU 314.111-112; Ex. 1133 [Goolsby Rep.] at ¶ 54-55.

[179] Ex. 1103 [2009 Risks Report Workpaper] at PWC 09116-17 (2009); Ex. 1081 [2010 Burrill & Company Audit Strategy Memo] at PWC 15315 (2010); Ex. 1069 [2011 Risks Report Workpaper] at PWC 21622-23 (2011); Ex. 1020 [2012 Risk Assessment Workpaper] at PWC 27182 (2012).

[180] In fact, Mr. Beamish took extraordinary steps to ensure that the significant risks were properly tested. For example, with respect to valuations, Mr. Beamish encouraged Burrill management to engage a third party valuation firm to help value the Fund's investments. Management followed his advice, retaining a reputable firm, Grant Thornton. *See* Ex. 1187 [Sen Dep.] at 35:7-36:24; 37:18-21; 38:7-25. Further, Mr. Beamish utilized the services of PwC's valuation specialists to assist with this audit area as well. These steps exemplify the due care and professional scepticism Mr. Beamish brought to identifying and responding to significant risks. *See* Ex. 1133 [Goolsby Rep.] at ¶ 52.

not allege any audit deficiency related to these audit areas or question Mr. Beamish's decision to identify them as significant risks.

With the benefit of hindsight, the Division argues the Relevant Transfers should have been deemed a significant risk, but a contemporaneous assessment of the relevant standards and facts point to a different conclusion. Indeed, Mr. Beamish's professional judgment that the Relevant Transfers did not represent a significant risk was reasonable given:

- The Relevant Transfers were not complex or uncommon for the Fund. They represented an advance payment of management fees to the General Partner, and management fees are both routine for venture capital funds and specifically contemplated in the LPA, an agreement entered into by all of the users of the financial statements.[181]
- There was no effort by management to conceal information.[182] The Relevant Transfers were properly documented in the Fund's financial records, were openly discussed by the entire management team with the auditors, and were consistently disclosed to investors in the Fund's financial statements without any objection by management, belying any inference that the Fund's management was engaged in fraud or unauthorized conduct.[183]
- The accounting for management fees was not complex, judgmental, or subject to estimation. Their calculation was simple and provided for in the LPA.[184]
- The Relevant Transfers were subject to an easily understood and well defined cash disbursement process, with key controls designed for proper authorization.[185]
- The management team never attempted to inflate accounts for their benefit. For example, management never tried to overstate the management fees, which were always correctly accounted for on the books. In addition, management did not

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[181] *See* Ex. 1133 [Goolsby Rep.] at ¶ 55-56.

[182] *See* Ex. 1187 [Sen Dep.] at 86:21-89:21 (stating that management did not withhold information from PwC and that PwC had an unfettered access to information).

[183] During the course of the audits, there was no contrary evidence that warranted a change in this conclusion. The existence and amount of the prepaid management fees were recorded in the company's own books and records and included in the draft financial statements as made available to the PwC audit team. (Ex. 1182 [Beamish Test.] at 100:16-19; 120:7-11; 161:10-11; 213:8-19). The transactions were known to all three management representatives who communicated regularly with the audit team, the payments were duly authorized under the company's policies, and management never resisted the disclosure of these payments in the Fund's financial statements. *Id.* at 104:3-10.) In Mr. Beamish's assessment, the fact that the existence of prepaid management fees was known to management and openly disclosed in the financial statements was consistent with the conclusion there were no significant fraud risk factors. *Id.* at 167:19-25; 168:1-7; 184:17-25; 185:1-25.

[184] *See* Ex. 1133 [Goolsby Rep.] at ¶ 55.

[185] *Id.*

attempt to overstate the valuation of its investments, but instead hired a well-respected independent valuation firm, Grant Thornton, to conduct its valuations.[186]

- The audience/users of financials were very sophisticated and never expressed concern. Given the salience of the Relevant Transfers in the financial statements and management's consistent and open disclosure of the Relevant Transfers, Mr. Beamish reasonably believed that the Relevant Transfers were a known practice at the Fund.[187]

It merits repeating that the nature of the Relevant Transfers did not warrant an elevated risk level. The Relevant Transfers could not have been simpler: they were straightforward transfers from the Fund to the General Partner. Cash was debited from the Fund and credited to the General Partner and its affiliates. There was no uncertainty regarding how to value the asset. The distributions were subject to internal controls. And, as a payment for management fees, these distributions were routine. GAAS specifically says that these types of transactions are generally less risky.[188]

GAAS provides that: "The determination of significant risks, which arise on most audits, is a matter for the auditor's professional judgment."[189] In Mr. Beamish's professional judgment, the Relevant Transfers did not pose a significant risk such that additional audit procedures were necessary to determine if there was a material misstatement. And, as will be discussed below, Mr. Beamish was correct in that assessment.

3. Mr. Beamish executed appropriate testing to validate that there was no material misstatement relating to the Relevant Transfers.

But even at a normal risk level, the audit team performed appropriate substantive testing of the Relevant Transfers to ensure that where was no material misstatement. The audit teams evaluated the operating effectiveness of the relevant controls and performed

[186] Ex. 1184 [Balsys Dep.] at 279:16-280:4, 302:23-303:15, Feb. 23, 2017; Ex. 1183 [Beamish Test.] at 300:17-301:25; Ex. 1133 [Goolsby Rep.] at¶ 52.

[187] Ex. 1133 [Goolsby Rep.] at ¶ 38.

[188] *See* Ex. 1146 [AU 314.111-112] ("Routine, noncomplex transactions that are subject to systematic processing are less likely to give rise to significant risks because they have lower inherent risks.")

[189] Ex. 1146 [AU 314.111].

appropriate substantive testing.[190] This testing included specific procedures to validate that the Relevant Transfers were authorized, the balances were collectible, and the disclosures were adequate.

First, Mr. Beamish performed tests to validate that certain controls were implemented and working as designed.[191] For example, the team tested that cash disbursements were properly approved and signed by an authorized signatory, and financial statements and memoranda to investors were distributed on Burrill & Company's Intralinks website on a quarterly basis. This testing gave the audit team a reasonable basis to conclude that Fund III controls were effective. Specifically, that the Relevant Transfers were authorized by the appropriate person, reconciled, and reviewed by the appropriate people.

Second, Mr. Beamish and the audit teams substantively tested virtually all of the individual items impacting the Relevant Transfers balances during each of the Relevant Audits. The substantive testing of this account included:

- holding discussions with management to obtain an understanding of the nature of the Relevant Transfers balance and underlying transactions;
- obtaining the general ledger detail to determine the nature of the additions and reductions to the Relevant Transfers balance and agree the beginning and ending balances to prior year and ending balances in the financial statements;
- vouching 100% of the cash disbursements (which increased the Relevant Transfers balance) to bank statements;
- agreeing the amount of quarterly management fees earned (which decreased the Relevant Transfers balance) to the amount recorded as an expense in the income statements;
- testing that 100% of the quarterly management fees earned and recorded in the income statement were calculated in accordance with the LPA; and

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[190] GAAS require auditors to "obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit." Ex. 1133 [Goolsby Rep.] at ¶ 58 citing Ex. 1148 [AU 326.01].

[191] Ex. 1085 [2010 Bank Reconciliations Are Performed Workpaper] at PWC 15547, Ex. 1062 [2011 Bank Reconciliations Workpaper] at PWC 21702, and Ex. 1018 [2012 Bank Reconciliations Workpaper] at PWC 27381; *see* Ex. 1133 [Goolsby Rep.] at ¶ 57 citing AU 318.45 ("if the auditor plans to rely on the operating effectiveness of controls intended to mitigate that significant risk the auditor should obtain audit evidence about the operating effectiveness of those controls from tests of controls performed in the current period").

- testing that the General Partner's deemed contribution offset complied with the LPA.[192]

This substantive testing revealed no exceptions and identified no contrary information.

Third, Mr. Beamish sought additional assurances that the Relevant Transfers were appropriately accounted for. These steps included assessing authorization, business purpose, and collectability. As will be demonstrated below and at the hearing, these efforts exemplify the due professional care and professional skepticism Mr. Beamish demonstrated during the Relevant Audits.

a) Mr. Beamish had sufficient evidence to determine that the Relevant Transfers were authorized.

Mr. Beamish gained appropriate evidence to determine that Steve Burrill and management had the authority to authorize the Relevant Transfers. As an initial matter, several provisions of the LPA support Mr. Beamish's conclusion that the transfers were authorized.[193] The LPA contains a provision that specifically contemplates that the Fund is obligated to pay the General Partner management fees.[194] Nowhere does that provision prohibit the prepayment of those management fees. Under the LPA, the "General Partner has the sole and exclusive right to manage, control, and conduct the affairs of the Partnership."[195] The LPA specifically lists Steven Burrill as a key-man,[196] giving him the "right to direct the decisions of the General Partner" and to engage in "transactions and investments not prohibited" by the LPA.[197]

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[192] *See* Ex. 1133 [Goolsby Rep.] at ¶ 61 (citing Ex. 1104 [2009 Recompute Management Fee and Testing Workpaper] at PWC 09391; Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 193360; Ex. 1065 [2011 Future Management Fee Calculation Workpaper] at PWC 22046; and Ex. 1028 [2012 Prepaid Expense Workpaper] at PWC 27630).

[193] Notably, Helena Sen testified that management also did not believe that the prepayments were unauthorized. *See* Ex. 1187 [Sen Dep.] at 112:2-7 (stating that there was no language in the LPA that forbid the prepayment of management fees); *id.* at 111:17-112:1 (stating that Mr. Hebert, who was very knowledgeable about the LPA did not say that the Relevant Transfers were not authorized).

[194] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00610-611.

[195] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] § 11.19 and LPA § 7.1 at PWC 00646.

[196] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00626-627.

[197] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00646.

But critically, under GAAS, the LPA is, at best, a secondary source of evidence to determine whether a transaction is authorized. GAAS conflates authorization with permission by the appropriate parties, stating: "Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance, or the entity's shareholders) for the entity to enter into specific transactions in accordance with predetermined criteria, whether or not judgmental."[198] Here, based on this actual GAAS standard, there was more than sufficient audit evidence for Mr. Beamish to determine the payments were properly approved and authorized.

In terms of approval, considering the evidence Mr. Beamish had available to him, he had multiple reasons to determine that management had the authority to cause the Relevant Transfers. First, the audit teams understood that the management team—specifically, Mr. Burrill, Mr. Hebert, and Ms. Sen—were authorized signatories of Fund III. Second, the audit teams understood that these same members of management and the GP explicitly approved the transfers and balances and all signed a management representation letter stating that the Fund had complied with all contractual agreements.[199] (Thus, each member of management confirmed his or her belief that the transactions were in compliance with the LPA.[200]) Third, the audit teams understood that Victor Hebert and Steven Burrill's approval of the Relevant Transfers was significant, not just because each was also a member of the GP but also because of their roles in the Burrill organization. Mr. Hebert's knowledge and approval of the

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[198] Ex. 1154 [AU-C 550:A21].

[199] Ex. 1099 [2009 Management Representation Letter] at PWC 32032; Ex. 1027 [2010 Management Representation Letter] at PWC 23787; Ex. 1049 [2011 Management Representation Letter] at PWC 33625; Ex. 1278 [Fund III Report to Management] at PWC 34424.

[200] Ex. 1133 [Goolsby Rep.] at ¶ 69. GAAS acknowledges that an "entity's transactions and the related assets, liabilities, and equities are within the direct knowledge and control of management." Ex. 1163 [AU 110.03]. *See also* management representation letters: Ex. 1099 [2009 Management Representation Letter] at PWC 32032; Ex. 1027 [2010 Management Representation Letter] at PWC 23787; Ex. 1049 [2011 Management Representation Letter] at PWC 33625; Ex. 1278 [Fund III Report to Management] at PWC 34424.; workpapers examining management competence: Ex. 1111 [2009 Fraud Risk Assessment Memo] at PWC 05867; Ex. 1093 [2010 Fraud Risk Agenda Workpaper] at PWC 15934;, Ex. 1066 [2011 Fraud Risk Agenda Workpaper] at PWC 22693; and Ex. 1029 [2012 Risks of Material Misstatement Due to Fraud or Error Workpaper] at PWC 28441.

prepayments was critical because he was the Fund's acting Chief Legal Officer.[201] Mr. Beamish and his team were aware that Mr. Hebert was a prominent and well-respected attorney who had served as the Co-Chairman of Heller Ehrman.[202] Steven Burrill's authorization was of particular significance given his authority to direct Fund III's actions as an Original Managing Member of the fund's General Partner.[203] Given the experience and authority of these individuals, it was reasonable for the audit teams to rely upon their representations that the prepayments were authorized.

Similarly, Mr. Beamish had ample evidence that the Relevant Transfers were at least implicitly approved. Neither the LPs nor the non-management members of the GP ever objected to the increasing receivable due from the GP despite their repeated disclosure. As described above, the financial statements, year after year, reported the Relevant Transfers as separate line items on the balance sheet and cashflow statement, as well as in a separate Related Party footnote calling out the payment of money from the Fund to the GP. The LPs also had direct access to management, including the right to access the Fund's books and records if they had concerns.[204] Mr. Beamish acted reasonably in concluding that GP and the LPs were aware and did not object to the Relevant Transfers, since they did not raise any objections after they were disclosed year after year in the financial statements.[205]

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[201] *See* Ex. 1187 [Sen Dep.] at 4:13-41:22; 42:12-44:2 (describing Mr. Hebert as Mr. Burrill's right hand man, who was charged with reviewing contracts); Ex. 1184 [Balsys Dep.] at 107:13-108:3, 109:24-110:5, 110:18-111:7, 111:22-112:4.

[202] *See* Ex. 1239 [Victor Hebert's Burrill & Company Profile]; Ex. 1182 [Beamish Test.] at 213:8-19.

[203] There were five Original Managing Members of the fund's General Partner. The other managing members were John Kim, Roger Wyse, Ann Hanham and Giovanni Ferrara. Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00646 . *See also* Ex. 1187 [Sen Dep.] at 40:13-41:22; 42:12-44:2 (stating that Burrill was the key man in charge of running the Burrill enterprise).

[204] Fund III's limited partners had the right under the LPA to inspect the Fund's complete books and records at any time (upon reasonable notice), had contact information for members of the General Partner, and would be given access to the Fund's auditors and accountants to discuss the finances of the Fund upon request. Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00633-634.

[205] Ex. 1187 [Sen Dep.] at 77:2-80:13.

b) Mr. Beamish Understood Fund III's Business Rationale with respect to the Relevant Transfers

GAAS states that an auditor should assess the business rationale of related party transactions that are "outside the normal course of business *for the entity*."[206] In this case, given the recurring nature of the transfers in plain and open view of the entire management team and the Fund's investors, without incident or question, it was reasonable to conclude that such payments were *not* outside the normal course of business. The payment of management fees was expressly provided for in the LPA.[207] The Division itself concedes that the General Partner was entitled to this management fee, which could, among other things, be used to pay personnel salaries.[208] With respect to Fund III, the prepayment of these management fees was normal.

Nevertheless, Mr. Beamish took appropriate steps to understand the Fund's business rationale for the Relevant Transfers. Mr. Beamish understood the Relevant Transfers to be "a prepaid balance with a management company that ha[d] a contract to perform management services for the fund."[209] This understanding, which explains the business purpose of the payments from the Fund to the General Partner, was sufficient given the risk level and the significant testing performed on each of these payments.[210]

Critically, Mr. Beamish did not have any obligation to go beyond this understanding to determine what the General Partner and the Management Company used the fees for once received.[211] PwC did not audit those entities, and how they spent the fees they were

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[206] Ex. 1147 [AU 316.66] and Ex. 1146 [AU 314.11].
[207] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00610-611.
[208] OIP at ¶ 12.
[209] Ex. 1181 [Beamish Dep.] at 132:18-20. Likewise, Mr. Beamish testified at length in his SEC investigative testimony that the manner in which the General Partner and its management company used the fees charged to the Fund was not relevant to his audit of the Fund's financial statements. Rather, such information "would only be relevant if we were auditing the management company, that wouldn't have changed the accounting. In terms of why the management company was using these, would not change the accounting for these within the Fund III financials." Ex. 1182 [Beamish Test.] at 105:24-106:3.
[210] Ex. 1133 [Goolsby Rep.] at § 14.
[211] *Id.* at ¶ 56.

contractually authorized to be paid is not relevant. As discussed below, what was relevant was whether the outstanding balance of the Relevant Transfers was collectible. Mr. Beamish had no indication that the prepayments signified an inability of the General Partner to make repayment. By all accounts, the General Partner was meeting its obligations to pay for the operations of the Fund, including salaries and rent, out of its fees. No other provision in the LPA had any bearing on how the General Partner's fees were to be used.

c) Mr. Beamish's Team Performed Significant Tests to Validate that the Relevant Transfers' Balance Was Properly Recorded.

Mr. Beamish took appropriate steps to obtain sufficient audit evidence that Burrill and the affiliated entities had the ability to repay the Relevant Transfers. Pursuant to GAAS, Mr. Beamish and his teams were required to assess the reasonableness of management's assertions regarding the collectability of the Relevant Transfers.[212] Collectability is also relevant to GAAP, which requires the audit team to assess whether the asset was properly recorded. Specifically, under GAAP, the Fund would need to record the Relevant Transfers as uncollectable if it were "likely" that the fund would not recover its asset, and the amount of the shortfall could be reasonably estimated.[213]

Each year, Mr. Beamish obtained sufficient evidence to conclude that the Relevant Transfers were collectable. Indeed, in 2013, when a new management company and a successor auditor had stepped in, even after allegations of fraud had been levelled against Mr. Burrill in connection with the prepaid expenses, the new management and auditor validated Mr. Beamish's conclusion that the asset was collectable in 2012.

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[212] Ex. 1168 [AU 342.04] ("[T]he reasonableness of accounting estimates made by management in the context of the financial statements as a whole.")

[213] Ex. 1133 [Goolsby Rep.] at ¶ 76 (citing ASC 310-10-35-07 and 08).

(1) The 2009 through 2011 Audits

For the 2009 through 2010 audits, the recoverability of the Relevant Transfers via future management services was not in question. During each of the Relevant Audits, PwC received a written representation letter from Burrill management stating that "[n]o losses are expected to be sustained on realization of the receivables."[214] In addition to obtaining representations from management, the audit team performed risk assessment procedures on the Relevant Transfers and developed specific tailored procedures to address the respective risks. One such procedure was documented as "recompute amounts expensed for the year (*i.e.*, amortization) and compare amounts expensed or written off with income accounts."[215] This procedure provided the audit teams with evidence that Fund III would realize the prepaid expense asset through future services provided by the management company. Based on these tests and the 2009 and 2010 teams' calculation of management fees earned by the management company (as stipulated in the LPA), it was evident that the 2009 and 2010 balances were recoverable through the provision of future management services.

As the Relevant Transfers' balance grew in 2011, the audit team performed additional procedures to test the recoverability of the balance by scheduling out expected future management fees and comparing that estimate to the year-end asset balance, making the express determination that the balance could be realized through the provision of future management services by the General Partner.[216]

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[214] Ex. 1099 [2009 Management Representation Letter] at PWC 32028. Similar language is found at Ex. 1075 [2010 Management Representation Letter] at PWC 32782; Ex. 1049 [2011 Management Representation Letter] at PWC 33620; and Ex. 1278 [Fund III Report to Management] at PWC 34418.

[215] Ex. 1087 [2010 Prepaid Expense Testing Workpaper] at PWC 19336; Ex. 1065 [2011 Future Management Fee Calculation Workpaper] at PWC 22046; and Ex. 1028 [2012 Prepaid Expense Workpaper] at PWC 27630.

[216] Ex. 1065 [2011 Future Management Fee Calculation Workpaper] at PWC 22046. While it was later determined that there was an error in the 2011 calculation of future fees, the runway of future management fees still exceeded the prepaid management fee balance. Even after accounting for the error, there was still sufficient management fees to be earned to offset the prepaid management fee balance. *See* Ex. 1133 [Goolsby Rep.] at ¶ 65; Ex. 1131 [Holder Rep.] at ¶ 66. Moreover, there is no dispute that the 2011 workpaper with the calculation error was not reviewed by Mr. Beamish, and it was not required under GAAS for the engagement partner to double-check mathematical computations of this nature. Ex. 1174 [AU 210.03] ("The engagement partner must exercise seasoned judgment in the varying degrees of his

Mr. Beamish had no reason to question that management would fulfill its obligations to provide the management services as required under the LPA. The General Partner was legally bound under the LPA to provide advisory services to the Fund. Burrill & Company was an established firm managing a number of funds, and there was no evidence that would have caused Mr. Beamish to question whether they would cease to perform management services for Fund III. Similarly, Mr. Beamish had no reason to question whether management would run out of operating funds. When investments were liquidated there would be additional sources of cash available to the General Partner to pay for management services. And, of course, as an investor and holder of a 20% interest in any Fund gains, the General Partner had a significant financial stake in providing management services for the remaining life of the Fund.

(2) The 2012 Audit

When in the 2012 audit year the Relevant Transfers' balance exceeded future estimated management fees for the contractual life of the fund, absent extension (venture funds are usually extended), the audit team took appropriate action. Notwithstanding the assessment, consistent with prior years, that the Relevant Transfers did not present significant fraud risk, the team—and Mr. Beamish personally—undertook additional procedures to assess the realizability of the balance and ensure the accuracy of the disclosures.

As in previous years, Mr. Beamish gained assurances through management representations and testing of the balance. Additionally, the efforts Mr. Beamish and the audit team performed to ensure management's assertions regarding collectability included:

- Obtaining a written representation from management—Steven Burrill, Victor Hebert, Helena Sen, and Jean Yang—that "[t]he Management Company intends to pay this amount to the Partnership from future distributions to the General Partner

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supervision and review of the work done and judgments exercised by his subordinates, who in turn must meet the responsibilities attaching to the varying gradations and functions of their work."); *see also* Ex. 1197 [Devor Dep.] at 34:15-19, 35:11-36:1, 36:12-21, 38:9-13.

and from Management Company funds. The Management Company has the ability and intent to fulfill this obligation."[217]

- Engaging in verbal conversations with Victor Hebert, Helena Sen, and Jean Yang. As detailed in the workpapers, the audit team understood from these conversations that "the GP intends to a) offset the excess of the prepayment with future distributions to GP which does not seem unreasonable since GP's capital account was $15.3m as of 12/31/2012 due to allocation of carry interest, or b) repay the fund."[218] Further, in a separate conversation with Victor Hebert, Mr. Hebert stated that the: "GP also has the ability to waive payment of future management fees to offset the prepayment in the event that the capital account balance does not fully cover the outstanding payable."[219] Notably, Mr. Beamish had a personal conversation with Victor Hebert, in which Mr. Hebert explicitly represented that the receivable would be repaid with the GP's capital account balance.

- Assessing the General Partner's capital account to determine the balance available. The audit team, under Mr. Beamish's direction, determined that there was approximately $26.2 million of aggregate value in future management fees and the Partner's capital account as of December 31, 2012. This represented about $8.3 million more than the Relevant Transfers' balance.

Given these considerations, in Mr. Beamish's professional judgment—which eventually proved correct—the capital account was an acceptable source for repayment: it offered more than enough money to cover the transfers exceeding the runway of future management fees.

But Mr. Beamish did not come to the conclusion that the GP could commit the capital account to repay the Relevant Transfers without at least a couple of key assurances. First, Mr. Beamish considered the fact that Steven Burrill and his management team—the same individuals that explicitly represented that the Relevant Transfers' balance was collectible—had the authority to control the actions of both the GP and the management company.[220] Steven Burrill was the managing member of the GP and sole owner of the management

[217] Ex. 1278 [Fund III Report to Management] at PWC 34418.

[218] Ex. 1028 [2012 Audit Prepaid Expense Workpaper in Excel] at PWC 27630.

[219] *Id.*

[220] Steve Burrill, as the Managing Member of the General Partner and sole owner of the management company, had the authority to control the actions of the GP and the management company. *See, e.g.*, Ex. 1046 [2012 Audit Adalia-Portfolio Advisors Transfer Agreement Workpaper] at PWC 29513. Further, Ms. Sen and Mr. Hebert had the authority to enter into agreements such as engaging Pricewaterhouse Cooper as the auditor to the Fund. Ex. 1048 [2011 Engagement Letter] at PWC 32835; Ex. 1008 [2012 Engagement Letter] at PWC 28430.

company. Also, both Helena Sen and Victor Hebert previously signed binding agreements on behalf of the GP.

Second, that the GP could repay this balance was consistent with Mr. Beamish's understanding of the nature of the Relevant Transfers. For fiscal years 2009 through 2011, the financial statements themselves expressly provided in the related party footnote that it was the GP which owed a receivable to the Fund for the Relevant Transfers, and thus it was hardly unreasonable for Mr. Beamish to believe that management could look to the General Partner for repayment in 2012. Notably, the other members of the General Partner, though active in the firm and receiving the financials every year, never raised any questions or concerns about the prepayments of expenses to the General Partner of which they were partial owners.

Given these considerations, it would only be appropriate for Mr. Beamish to conclude that the Partnership account should not be impaired, and there was no need to examine the GP's organizational documents to gain certainty that Mr. Burrill had the authority to commit the capital account to repay the Relevant Transfers.[221]

(3) 2013 BDO Audit

Mr. Beamish's reasonable conclusion that the prepaid expense asset remained collectable in FY 2012 was verified by the work of BDO, the successor auditor that audited the Fund's 2013 financial statements. Even after the General Partner was removed based on allegations concerning the prepaid management fees, the new general partner, with BDO's concurrence, validated PwC's work. The Fund's 2013 financial statement did not restate the beginning balance of 2013 partners' capital account, "indicating that the Fund's management and its subsequent independent financial statement auditor (BDO) *agreed* with management's

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[221] In fact, the General Partner Limited Partnership Agreement did in fact authorize these transactions. *See* Ex. 1215 [Fund III Management Agreement] at § 4.1.1(b) ("[A]ll decisions or actions which this Agreement provides may be made by "the Members" may be made by any Member acting individually unless as otherwise indicated.")

prior judgment that the prepaid expense/receivable was realizable through December 31, 2012."[222] BDO and the new general partner's decision to carry forward the balances without adjustment means that *neither* challenged Mr. Beamish and the PwC's audit teams' 2012 collectability analysis, which is all the more noteworthy because both had the benefit of hindsight at the time they made that determination.[223]

Had BDO disagreed with the PwC audit team's assessment of the collectability of the Relevant Transfers at December 31, 2012, professional standards would have required BDO to have Fund III adjust the opening equity balances as of January 1, 2013, and include an accompanying footnote disclosure discussing that adjustment. Instead, the Fund wrote off the Relevant Transfers' balance as a *2013* event, meaning it determined that the Relevant Transfers was not collectible as of 2013. Mr. Beamish should not be sanctioned where, as here, objective, independent, contemporaneous assessments support Respondent's audit opinions and GAAS compliance.[224]

C. The Division's Critiques of Mr. Beamish's Compliance with GAAS are Meritless

Unlike typical enforcement actions alleging deficient audits, this case does not involve issues that were overlooked by auditors and omitted from financial statement disclosure. Mr. Beamish identified the issues raised by the Relevant Transfers and his team took appropriate audit steps regarding testing and disclosure. The Division is thus left to argue, through its expert Mr. Devor, that the auditors missed certain red flags—yet the issues

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[222] Ex. 1132 [Holder Rebuttal Rep.] at ¶ 35 (emphasis added). *See also* Ex. 1133 [Goolsby Rep.] at ¶ 86; Ex. 1005 [Fund III, L.P. 2013 Financial Statements] at SEC-PG-P-0000614.

[223] Ex. 1196 [Holder Dep.] at 200:1-11.

[224] In questioning one of Mr. Beamish's experts, the Division suggested that the Fund's new management did not restate the 2012 financial statements because they decided "it was unnecessary to incur the cost of restating the 2012 financial statements." *Id.* at 205:20-24, question from R. Tashjian. However, management does *not* have the option to forgo restating material misstatements in order to avoid costs, and BDO could not have issued the unqualified opinion they issued if they determined that the closing balances from 2012 were materially misstated. *Id.* at 205:25-206:17. In any event, it is somewhat astounding that the Division seeks to end Mr. Beamish's career based on his treatment of the prepaid expenses, while brushing off an identical conclusion reached by the successor auditor because for them to have undergone a restatement would have been *too expensive*.

they identify were neither missed nor red flags. Rather, the Division's case rests on inappropriate hindsight evaluation and hypotheticals, a selective telling of the facts, and mischaracterizations of GAAS.[225] As discussed below and as will be presented at the hearing, in each of the areas identified by the Division as deficient, Mr. Beamish took the necessary audit steps to gain reasonable assurance that the financial statements would be free of material misstatement.

1. The Fund's Brief Consideration of a Note Is Not Indicative of Fraud.

The evidence confirms that Mr. Beamish acted appropriately in his treatment of management's withdrawn promissory note. On April 1, 2013, management disclosed to the audit team that it had entered into a promissory note.[226] The team learned that Marc Berger, a tax partner with Burr Pilger Mayer had suggested the promissory note for tax strategy purposes related to the Management Company, an entity that PwC did not audit.[227] Consistent with GAAP, the audit team suggested draft disclosure language assuming the note was finalized and valid as of the audit report date.[228] However, only days after learning of the note, Fund III management informed PwC that it had reconsidered the transaction and decided to rescind the note.[229]

Financial reporting is not intended to capture or report on planned or intended business actions that are changed or never consummated prior to issuing the financial

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[225] All of the issues come to a head in the expert statement of Mr. Devor. As will be detailed in a motion in limine, Mr. Devor's statement is rife with factual and GAAS-based errors.

[226] Ex. 1183 [Beamish Test.] at 263:10-16; Ex. 1269 [Email from Jonas Balsys re Promissory Note] at PWC 50170, 50171.

[227] Ex. 1188 [Sen Test.] at 824-25; Ex. 1181 [Beamish Dep.] at 69:15-23; Ex. 1183 [Beamish Test.] at 287:18-288:21; Ex. 1185 [Balsys Test.] at 89:24-90:6; Ex. 83 [Email from Helena Sen re Re: Prom note related party, 4/4/13] at PWC 50946.

[228] Ex. 1133 [Goolsby Rep.] at ¶ 102; Ex. 82 [Email from Jonas Balsys re Fw: Suggested language for note disclosure, 4/3/13] at PwC 50303.

[229] Ex. 83 [Email from Helena Sen re Re: Prom note related party, 4/4/13] at PwC 50946. The 2012 engagement team also obtained a written representation from management that "No promissory notes or other similar instruments were outstanding [for the amount of prepaid expenses and other receivables from related party] at December 31, 2012 or April 4, 2013." Ex. 1278 [Fund III Report to Management] at PWC 34418; *see also* Ex. 1276 [Email from Jonas Balsys re RE: Fund III management rep. letter] at PWC-BU-SFCX 00171821.

statements.[230] Thus, once the note was withdrawn, there was no purpose (or requirement) for the 2012 financial statements to disclose the note since it was not in existence as of year-end, or as of the April 4th audit report date.[231]

The Division contends that management's decision to withdraw the note should have put Mr. Beamish on notice at the time of some fraud risk.[232] However, it is common for management to consider or plan to enter a particular transaction or agreement and then reconsider following future discussions or deliberations.[233] Management openly disclosed to Mr. Beamish and his audit team the existence of the note, its terms, and the reason it was being contemplated. Mr. Beamish understood that the note was intended to address tax issues, something that is not unusual for companies to consider.[234] Mr. Beamish had no knowledge why Mr. Burrill ultimately decided against entering the promissory note, but merely that over the course of a three-day period, management weighed its options and opted against the note.[235] Thus, the circumstances surrounding the note did not rise to the level of requiring heightened skepticism. Further, it would have been inappropriate, under GAAS, for Mr. Beamish to second-guess business decisions for his audit client.[236]

Importantly, as described above, the final version of the footnote fully disclosed the existence, amount, and manner of settlement of the receivable itself.

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230 Ex. 1133 [Goolsby Rep.] at ¶ 103.

231 *Id.*

232 OIP at ¶ 31 and 40; Ex. 300 [Devor Rep.] at ¶¶ 226, 261, 272, 278, 290, 292, 309.

233 Ex. 1133 [Goolsby Rep.] at ¶ 103; Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 47; Ex. 1196 [Holder Dep.] at 162:16-163:3.

234 Ex. 1133 [Goolsby Rep.] at ¶ 103; Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 47; Ex. 1185 [Balsys Test.] at 94-98.

235 Ex. 1133 [Goolsby Rep.] at ¶ 103; Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 47; Ex. 1185 [Balsys Test.] at 94-98; Ex. 1181 [Beamish Dep.] at 69:15-23; Ex. 1183 [Beamish Test.] at 287:18-288:21; Ex. 1185 [Balsys Test.] at 89:24-90:6.

236 Ex. 1133 [Goolsby Rep.] at ¶ 103.

2. The LPA Does Not Support The Division's Assertion that the Relevant Transactions Were Unauthorized, and Mr. Devor is not Qualified to Offer That Opinion.

There is not a single provision in the LPA that expressly prohibits the prepayment of management fees—this is not in dispute. In place of an express provision, the Division, through its accounting expert, Mr. Devor, seeks to draw attention to other provisions of the LPA unrelated to the payment of management fees. Mr. Devor then attempts to assert his own legal interpretation that those provisions "in fact" prohibited prepayments of management of fees, because he believes they were not "in the Fund's best interest."[237] But these legal conclusions are without merit.[238]

First, Mr. Devor is an accountant and is not qualified to offer a legal opinion. Second, Mr. Devor's attempt to offer such an opinion reflects a fundamental misunderstanding of the role of the auditor. Although accountants must often use their professional judgement to make accounting interpretations of contractual "agreements in performing their work, the determination of whether an act is, in fact, illegal or in violation of an agreement is normally beyond the accountant's professional competence."[239] Further, an independent auditor does not opine on whether transactions are in the best interest of a company, and an audit should not influence the manner in which management operates the business enterprise.[240] Thus, Mr. Devor's conclusion that the prepaid fees were "in fact" in violation of the LPA because they are not in the Fund's "best interest" is not a determination he can make – just as it would have been inappropriate for Mr. Beamish to make during the Fund III audits.

Third, as explained further above in Section IV.B.3.a, Mr. Devor ignores keys facts, including other provisions of the LPA and additional audit evidence that the LPs and other

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[237] Ex. 300 [Devor Rep.] at ¶ 15.

[238] GAAS does not require that Mr. Beamish make a legal conclusion about the LPA; it only asks that he have a reasonable basis for his conclusion. Ex 1159 [AU 150.02].

[239] Ex. 1132 [Holder Rebuttal Rep.] at ¶ 26.

[240] Ex. 1131 [Holder Rep.] at ¶¶ 20-22.

members of the GP had delegated significant latitude to the GP's management company and Mr. Burrill in determining what was the in the Fund's best interest and deciding to authorize these payments.

Mr. Devor's opinion that the Relevant Transfers "more accurately constituted the improper withdrawal of Fund assets"[241] and therefore should have been recorded as an "expense" rather than a prepaid or receivable derives from his apparent legal conclusion that the payments were made in violation of the LPA. Since that legal conclusion is unsupported and improper, Mr. Devor's assertion that the transactions should have been recorded as expenses is equally without merit. As explained further above in Section III.B., the transactions were properly recorded as either a prepaid expense or receivable in each of the relevant years.

3. Mr. Beamish had no Reason to Question the General Partner's Access to its Capital Account.

The Division, through its expert, hypothesizes that the General Partner's access to the capital account could have been impaired either because of the Fund's failure to make a capital contribution in 2012[242] or because of the manner in which the Fund satisfied its deemed contribution from 2009-2012 was not permitted under the LPA.[243] From this entirely speculative assertion, the Division contends that the GP's multi-million dollar capital account could not have been viewed as a basis for Mr. Beamish to conclude in 2012 that the receivable was collectible.

a) Capital Contributions

The Division's argument that the General Partner may have jeopardized its right to its capital account as a result of its failure to make a single, immaterial capital call in 2012 is

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[241] Ex. 300 [Devor Rep.] at ¶ 124.
[242] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PWC 00600; Ex. 300 [Devor Rep.] at ¶ 14; OIP at ¶ 35.
[243] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement]; Ex. 300 [Devor Rep.] at ¶ 87 n.16; OIP at ¶ 35.

divorced from reality. The Division argues that Mr. Beamish had a duty to both make a legal determination that the General Partner breached the LPA and to speculate what the LPs might do in response to an alleged breach. However, no such obligation exists under GAAS.[244] Here, the audit team performed tests to recalculate the amount of the contribution that had not yet been paid, and validated it had been disclosed properly as an offset to the capital account. And, based on Mr. Beamish experience and judgment, he understood that that the capital contributions not yet paid would not impact the collectability of the receivable.

At the time, Mr. Beamish had no indication that there was a prospect for the GP's removal. Per the LPA, the Limited Partners *could* remove the General Partner in the event of a missed capital call, with a two-thirds vote.[245] But Mr. Beamish understood that the LPs were unlikely to pursue such a drastic course for such a relatively small amount of money, late in the Fund's life cycle—especially considering that the issue was disclosed, and there had been no action against LPs who had not yet paid their capital calls. No reasonable limited partner would risk a $283 million dollar investment over a $225,000 capital call.

Moreover, if the GP had been removed, the LPs had the right to reallocate the GP's capital account. This in fact came to pass a year later. (As a result, the very money that the Division argues was uncollectable in the event of a breach was actually recouped by the Fund.) Given that the GP's capital account was valued at $15.3 million – and only a portion of that was needed to repay the Relevant Transfers – Mr. Beamish was reasonable to determine that the capital account was sufficient to cover the General Partner's obligations.

b) Deemed Contributions

In his report, Mr. Devor further alleges that other capital contributions—specifically "Deemed Contributions"—were not "technically made."[246] None of these allegations were

[244] Ex. 1134 [Goolsby Rebuttal Rep.] at ¶ 55; *see* Ex. 1132 [Holder Rebuttal Rep.] at ¶ 28.
[245] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] at PwC 00625.
[246] Ex. 300 [Devor Rep.] at ¶ 138.

contained in the OIP and therefore they are not appropriate for consideration. In any event, his understanding is wrong. The LPA explicitly permitted the General Partner to make 80% of its capital contributions as Deemed Contributions, by reducing the claimed management fees owed to it by that amount.[247] PwC's workpapers document that the General Partner continued to make capital contributions in this manner each year.[248] To the extent that Mr. Devor takes issue with the General Partner making its contribution in this manner, his arguments are duplicative of his arguments about the Relevant Transfers more broadly.

V. THE DIVISION CANNOT ESTABLISH A CLAIM UNDER COMMISSION RULE OF PRACTICE 102(e)

The Division's case under Rule 102(e) is both legally and substantively deficient. As discussed below, and will be presented at the hearing through expert testimony of former SEC accounting officials Howard Scheck and John Riley, Rule 102(e) is not appropriately invoked to penalize accountant conduct having no nexus to the SEC's processes, as is the case in this matter. Further, the evidence regarding Mr. Beamish's performance of the audits in question does not satisfy the Division's burden of establishing improper professional conduct under Rule 102(e).

A. The Division cannot use 102(e)(1)(ii) to sanction Mr. Beamish for his audit of a private venture capital fund.

The Division's application of Rule 102(e) to define the parameters of "improper professional conduct" in auditing a purely private investment fund represents an unwarranted expansion of the SEC's authority beyond the scope and intent of the Rule. The Division challenges the audits of financial statements never filed with the Commission and never made available to public investors. Mr. Beamish was not appearing or practicing before the Commission in performing these audits, and his professional conduct had absolutely no

[247] Ex. 1007 [Fund III, L.P. Limited Partnership Agreement] § 3.4 at PWC 00660.
[248] Ex. 1001 [Fund III, L.P. 2009 Financial Statements] at PWC 20045; Ex. 1002 [Fund III, L.P. 2010 Financial Statements] at PWC 36011; Ex. 1003 [Fund III, L.P. 2011 Financial Statements] at PWC 43414; Ex. 1004 [Fund III, L.P. 2012 Financial Statements] at 19.

connection to the Commission's processes that Rule 102(e) is intended to protect.[249] Further, there is no evidence that Mr. Beamish poses a threat to the Commission's processes.[250] His record on public company audits is spotless, and as described above, his accounting on this matter was correct and has not been restated.[251] No court has sustained application of the Rule in circumstances even remotely like these, and the Division's attempt to apply the Rule beyond its boundaries should be rejected here.

1. When Auditing Fund III, Mr. Beamish was not Practicing Before the Commission.

That Mr. Beamish was not practicing before the Commission during the Fund III audit is not controversial.[252] The SEC's own rules define practicing before the Commission to include the "preparation of any statement" filed with the Commission. *See* Rule 102(f). In contrast to public company financial statements, Fund III's audited financial statements were never filed with SEC, reviewed by SEC personnel, or made available to the investing public through the SEC.[253]

Venture capital funds such as Fund III operate purposefully outside of the scope of the Commission's jurisdiction.[254] They are not required to register with the Commission. They are exempt from filing audited financial statements with the Commission.[255] And, their financial statements are audited under AICPA standards, not PCAOB standards.[256] On an

[249] *See* Ex. 1129 [Scheck Rep.] at 4-5.
[250] *See id.* at 10-11.
[251] *See id.*
[252] Notably, the OIP does not allege any nexus between the alleged conduct and the Commission's processes. Further, the Division's expert, Harris Devor, evaluates Mr. Breamish's audit conduct under the standards promulgated by the AICPA, which sets the standard for non-public audits. *See* Ex. 300 [Devor Rep.] at ¶ 4; Ex. 1133 [Goolsby Rep.] at ¶ 15.
[253] *Id.*
[254] SEC Release IA-3222 at p. 37 (citing S. Rep. No. 111-176, at 74-5 (2010)).
[255] U.S. SECURITIES AND EXCHANGE COMMISSION, IM GUIDANCE UPDATE: GUIDANCE ON THE EXEMPTION FOR ADVISERS TO VENTURE CAPITAL FUNDS, NO. 2013-12 (Dec. 2013), https:www.sec.gov/divisions/investment/guidance/im-guidance-2013-13.pdf, citing Section 201(l) of the Advisers Act. Exemptions for Advisers to Venture Capital Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers, Act Release No. 3222 (June 22, 2011).
[256] *See* Ex. 1130 [Riley Rep.] at ¶ 43.

operational and practical basis, venture funds have the same relationship with the Commission as any small, privately held business.

Congress, even while expanding the SEC's oversight of private investment funds, deliberately placed venture capital funds outside of the Commission's jurisdiction for a specific reason: their activities do not implicate the investing public. *See* 15 U.S.C. § 80a-3(c)(1) (July 22, 2010); *see also* SEC Rule 203(l)-1, 17 C.F.R. § 275.203(l)-1 (defining a venture capital fund) (specifically exempting venture capital funds from mandatory reporting requirements). Because of the inherent risk of early-stage investing, only highly resourced, accredited investors can invest in a venture capital fund and become a partner in the endeavor.[257] The fund's financial statements are available only to those partners. The investing public has no ability to access a fund's financial statement through the SEC, nor would they ever be in a position to rely on those statements in making investment decisions.[258] There is simply no nexus between Mr. Beamish's audits of Fund III and the SEC's own processes and procedures.

2. Rule 102(e) authorizes the Commission to sanction professionals for improper professional conduct only where the purported wrongful conduct undermines the Commission's own processes by placing public investors at risk.

Rule 102(e) operates specifically and exclusively within the confines of the Commission's processes. Courts considering the scope of the Rule have consistently emphasized that its imperative is "protecting the integrity of the *Commission's own processes.*" *Marrie v. SEC*, 374 F.3d 1196, 1200-01 (D.C. Cir. 2004) (emphasis added). Courts have reasoned that because "there is no express statutory provision authorizing the Commission to discipline professionals appearing before it," Rule 102(e) "represents an

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[257] An accredited investor includes anyone who earned over $200,000 ($300,000 together with a spouse) in each of the prior two years or, has a net worth over $1 million. SEC website, U.S. Securities Exchange Commission, Investor Bulletin: Accredited Investors (9/23/13), https://www.investor.gov/additional-resources/newsalerts/alerts-bulletins/investor-bulletin-accredited-investors, last accessed 2/13/17.

[258] *See* Ex. 1133 [Goolsby Rep.] at ¶ 15; Ex. 1129 [Scheck Rep.] at 4-5.

attempt by the Commission to protect the integrity of its own processes." *Touche Ross & Co. v. SEC.*, 609 F.2d 570, 582 (2d Cir. 1979).

Both the Commission and federal courts have emphasized the role of Rule 102(e) in the context of public company audits. For example, in the 1998 release amending Rule 102(e)(1)(ii), the sole provision at issue in the present matter, the Commission stated: "One of the most significant roles [accountants play] is in auditing financial statements filed with the Commission." Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57164, 57175 (Oct. 26, 1998) (codified at 17 C.F.R. pt. 201). The release further explained, "[c]orporate financial statements are one of the primary sources of information available to guide the decision of the investing public," and that "[i]nvestors have come to rely on the accuracy of the financial statements of public companies." *Id. See also Marrie v. SEC*, 374 F.3d at 1200-01 (noting that these Rule 102(e) amendments recognized "the particularly important role played by accountants in preparing and certifying the accuracy of financial statements of public companies that are so heavily relied upon by the public in making investment decision").

Allowing the Division to seek or the SEC to impose a practice bar based on conduct which is not related to practicing before the SEC and has no connection to the SEC's processes is untethered to any limiting principle. That the individual may also perform public company audits (or may in the future) does not give the Division carte blanche to level improper professional conduct allegations for work unrelated to the SEC's processes. Under the Division's reading, the SEC could institute proceedings against the accountant for the local convenience store for deficient bookkeeping on the theory that he or she may one day audit a public company making filings with the SEC.[259] By the same token, nothing would

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[259] Note that the SEC can prevent an accountant who has violated the federal securities laws from appearing before it under Rule 102(e)(1)(iii), thus protecting its processes from professionals whose conduct clearly implicates securities law. But where, as here, there is no allegation that any securities laws were broken, there must be some nexus between the conduct and the SEC in order to justify SEC discipline. If the

prevent the SEC from bringing Rule 102(e) proceedings against an attorney for professional malpractice in a slip-and-fall case, again out of ostensible concern about some future appearance before the SEC as an attorney. But the Division has never brought a case against an attorney under those circumstances or ever asserted that it has such authority. *See, e.g., In the Matter of Steven Altman, Esq.*, Admin. Proceeding File No. 3-12944, 99 SEC Docket 2744, Order at 25 (Nov. 10, 2010) (attorney charged with improper professional conduct under Rule 102(e) was practicing before the Commission when he engaged in misconduct in connection with representing of a witness during an SEC investigation).

No court has ever upheld the application of Rule 102(e)(1)(ii) to purportedly improper professional conduct that occurred during the audit of a purely private entity. To the contrary, decisions interpreting the scope of Rule 102(e) (both by the courts and the SEC itself) have expressly examined the nexus between the auditor's conduct and the preparation of financial statements filed with the SEC. *See, e.g., SEC v. Prince*, 942 F.Supp.2d 108, 145-147 (D.D.C. 2013) (holding that an accountant was "practicing before the Commission" because he was making accounting determinations that were "incorporated in filings before the Commission"); *Robert W. Armstrong III*, Admin. Proceeding File No. 3-9793, 85 SEC Docket 2321, Order at 20-21 (June 24, 2005) (accountant was practicing before the Commission when he prepared but did not sign a document filed with the Commission).[260]

The Division can point to no authority holding that an audit of a private venture capital fund constituted an appearance before the Commission for purposes of Rule 102(e)(1)(ii). While the SEC has instituted several recent settled actions involving private

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Division is allowed to use 102(e)(1)(ii) in these circumstances, the Division would have gained the ultimate regulatory weapon—the ability to bring a disciplinary proceeding against any accountant, for any purported act of professional negligence, and act as a nationwide regulator of accountant professional conduct. Nothing in the regulatory history of Rule 102(e) supports such a mandate.

[260] While *Armstrong* included dicta (repeated in *Altman*) to the effect that the conduct did not need to be in connection with an appearance before the Commission, the fact is that the Commission's ruling in Armstrong rested on the fact that the accountant was, in fact, practicing before the Commission at the time he engaged in the purported misconduct.

funds (*see, e.g.*, *Alpha Titans LLC*, Admin. Proceeding File No. 3-16520, Order (Apr. 29, 2015)), because the issue was not litigated in those matters they provide no precedential value. And in the lone litigated case involving a private fund, *In the Matter of Wendy McNeeley, CPA*, the issue was never raised. Admin Procceding File No. 3-13797, 105 SEC Docket 655, Order (Dec. 13, 2012) [hereinafter *McNeeley*]. Moreover, *McNeeley* was not appealed to a federal court of appeals and thus no court ruled on the SEC's application of its own rule. Finally, the auditor in *McNeeley* audited both a private fund *and its registered investment advisor*, which established a clear link to the Commission's processes that is not present here. *Id.* at 1.

Beyond the published decisions, it is also highly informative that John Riley and Howard Scheck, two former SEC officials charged with evaluating the proper meaning and scope of Rule 102(e)(1)(ii) on behalf of the agency, have submitted reports establishing that the Rule has not historically been interpreted by the SEC as empowering it to police audits of private venture capital funds.[261] Neither of these SEC veterans has seen the Rule applied as it is being applied in this case. And, neither believe it is necessary or advisable for the Rule to be applied in this manner in order to protect the Commission's processes.

This evidence of lack of prior use is highly relevant because, as the Supreme Court stated in *Bankamerica Corp. v. United States*, "just as established practice may shed light on the extent of power conveyed by general statutory language, so the want of assertion of power by those who presumably would be alert to exercise it, is equally significant in determining whether such power was actually conferred." 462 U.S. 122, 131 (1983) (citation omitted). Rule 102(e)(1)(ii) has never been understood or held to authorize the SEC to assess the professional conduct of accountants not practicing before the agency in connection with their work at issue in the matter.

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[261] *See* Ex. 1130 [Riley Rep.] at ¶ 36, 39; ; *See generally* Ex. 1129 [Scheck Rep.].

3. The Division's Attempted Expansion of Rule 102(c) Violates Mr. Beamish's Due Process Rights.

The extension of Rule 102(e) to the present circumstances is not only inconsistent with the language and intent of the Rule, but also raises significant due process issues under the Constitution.

Due process and bedrock principles of administrative law forbid federal agencies from punishing past conduct based on requirements they only subsequently articulated. "[E]lementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that [the government] may impose." *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 417 (2003) (citations omitted). In the context of agency rulemaking, "[i]t is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable when the agency announces its interpretations for the first time in an enforcement proceeding." *Christopher v. SmithKline Beecham Corp.*, 132 S. Ct. 2156, 2168 (2012).

Given the history of Rule 102(e) and the absence of comparable actions, no reasonable auditor would have understood that the Division could punish an auditor based on purportedly unprofessional work for a private venture capital fund.[262] Put bluntly and colloquially, no auditor could realistically have considered his entire public audit career at risk in each private audit he performed – that one slip in a private audit could lead here, with the devastating consequences it entails. The real world ramifications of this lack of notice are significant. For example, while deficient audits of public companies may result in Rule 102(e) proceedings, additional backstops for auditors of public companies exist, including:

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[262] *See generally* Ex. 1130 [Riley Rep.] at ¶¶ 33-39; Ex. 1129 [Scheck Rep.] at 8-9 (stating that, in their professional experience, they have not seen a rule 102(e) proceeding brought against an auditor based on alleged improper conduct with respect to a private entity).

financial statements filed with the Commission are subject to a review process that provides opportunities to address potential SEC staff concerns; public companies, unlike most private funds, have audit committees providing an extra layer of review of financial statements; and accounting firms must staff a concurring partner on all public company audits.[263] Changing the liability calculus impacts the engagement decisions made by accounting firms and their partners and employees. If the Division wishes to police private audits like public audits, it is fundamentally unfair to do so without giving professionals the opportunity to adjust their practices.

B. The Division Cannot Meet Its Burden of Proof Under Rule 102(e)

Even if this Court were to create new law and hold Rule 102(e)(1)(ii) applicable to audits of private venture capital funds, the Division cannot show that Mr. Beamish engaged in improper professional conduct under the Rule.

"Improper professional conduct" is defined to include both intentional, knowing, or reckless conduct, as well as certain types of negligent conduct. *See* Rule 102(e). Here, the Division does not allege that Mr. Beamish engaged in any knowing or reckless conduct, and is proceeding under a theory of negligence. To make such a showing, the Division has two options. First, it can prove that Mr. Beamish committed "a single instance of highly unreasonable conduct that result[ed] in a violation of applicable professional standards in circumstances in which [he knew, or should have known] that heightened scrutiny [was] warranted." 17 C.F.R. § 201.102(e)(1)(iv)(B)(1). Second, the Division can show that Mr. Beamish engaged in "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." 17 C.F.R. § 201.102(e)(1)(iv)(B)(2); *see also Marrie v. SEC*, 374 F.3d 1196, 1206, 08 (D.C. Cir. 2004).

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[263] *See* Ex. 1130 [Riley Rep.] at ¶¶ 44-49.

1. The Division Must Show that Mr. Beamish Engaged in *Highly* Unreasonable Conduct.

The Division seeks to keep both of the above-mentioned paths available to prove improper professional conduct.[264] But the OIP does not offer allegations to support a finding of repeated instances of unreasonable conduct. All the allegations concern a single audit issue, which, even if repeated over multiple years, does not trigger the "repeated instances" prong of Rule 102(e). Therefore, the Division can only prevail by showing Mr. Beamish committed a single instance of highly unreasonable conduct.

In the Commission's commentary on the final rule amending Rule 102(e), the Commission wrote that "repeated" may encompass: 1) two or more *separate* instances of unreasonable conduct occurring within one audit, or 2) separate instances of "unreasonable conduct with different audits [such as] fail[ing] to gather evidential matter *for more than two accounts*, or certify[ing] accounting inconsistent with GAAP *in more than two accounts.*" Amendment to Rule 102(e), Exchange Act Release No. 33-7593, 63 Fed. Reg 57,164, 57,166 (Oct. 26, 1998) ("Rule 102(e) Release") (emphases added). The Commission explicitly refers to errors relating to more than one "account." It is axiomatic in accounting that an "account" is represented by a single ledger to which postings are made to reflect individual transactions.

As the Commission further explained:

> *[A] single error* that results in an issuer's financial statements being misstated in more than one place would not, by itself, constitute a violation of this subparagraph. Certification of accounting inconsistent with GAAP in *two or more situations*, however, may indicate an accountant's basic unfamiliarity with the standards of the profession, which may constitute improper professional conduct under subparagraph B(2).

See id. (emphases added).

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[264] The OIP alleges that Mr. Beamish's conduct in auditing Fund III in 2012 constitutes an instance of highly unreasonable conduct. With respect to the 2009 through 2012 audits, the OIP alleges that Mr. Beamish's conduct constitutes repeated instances of unreasonable conduct. *See* OIP ¶ 49.

At issue in this matter is a single purported error: the treatment of prepaid management fees. That this same issue is present in multiple years does not somehow turn this into a multiple-issue case. Hence, the Division must demonstrate highly unreasonable conduct, a burden the evidence simply does not support.

2. The Court Should Not Second-Guess Difficult But Reasonable Judgment Calls Made by a Professional.

Regardless of whether the Division must show repeated acts of unreasonable conduct, or a single instance of highly unreasonable conduct, the Division cannot meet its burden. These heightened negligence provisions are "not intended to cover all forms of professional misconduct," but rather only egregious lapses in professionalism evidencing a threat to the Commission's mission of protecting the investing public. *Id.* at 57,165-66; *see McNeeley*, Exchange Act REl. No. 64831, 105 SEC Docket 655, 2012 SEC LEXIS 3880, at *48-55 (Dec. 13, 2012).

The gravity of a Rule 102(e) sanction "should not be underestimated." *Checkosky v. SEC*, 23 F.3d 452, 479 (D.C. Cir 1994). A finding against the 46-year-old Mr. Beamish could destroy "a way of life to which he has devoted years of preparation" and threaten his "entire livelihood." *Id.* (internal quotation marks omitted).

Given these significant ramifications, the Commission has emphasized that Rule 102(e) was "*not* intended to cover all forms of professional misconduct" (emphasis added) or "to add an additional weapon to its enforcement arsenal." Rule 102(e) Release at 57165-66. Further, to ensure fidelity to the rule, the Commission must avoid characterizing as negligent "difficult judgment calls made by a professional—which subsequently prove to be incorrect." *In the Matter of Robert D. Potts*, Exchange Act Rel. No. 39126, 53 SEC Docket 187 (Sept. 24, 1997) (Comm'r Wallman, dissenting). It is not appropriate to "evaluate [an accountant's] actions or judgments in the stark light of hindsight" rather than by assessing how a "reasonable accountant" would act "faced with the same situation" and "at the time of the

[alleged] violation." Rule 102(e) Release, 63 Fed. Reg. at 57,168. While the Division may disagree with certain of the accountant's judgments, any determination regarding the unreasonableness of the conduct may not be based on "subjective second-guessing of auditing judgment calls." *Marrie*, 374 F.3d at 1206.

The Commission and the courts have recognized limitations upon the scope of Rule 102(e)'s heightened negligence standards. First, the standards explicitly exclude "acts of 'simple negligence' and errors in judgment." 63 F3d. Reg. 57,164, 57,167 (internal quotations omitted). Further, Rule 102(e) "does not permit judgment by hindsight, but rather compares the actions taken by an accountant at the time of the violation with the actions a reasonable accountant should have taken if faced with the same situation." *Id.* at 57,168. Finally, the Commission must avoid characterizing as negligent "difficult judgment calls made by a professional—which subsequently prove to be incorrect." *Potts*, Exchange Act Rel. No. 39126, 53 SEC Docket 187 (Sept. 24, 1997) (Comm'r Wallman, dissenting).

As the Commission has acknowledged, a professional often must make difficult decisions, navigate complex statutory and regulatory requirements, and comply with professional standards. These determinations require independent and professional judgment and sometimes involve matters of first impression. *In the Matter of David J. Checkosky*, Admin File No. 3-6776, 63 SEC Docket 1691 (Jan. 21, 1997) (Comm'r Johnson, dissenting), *rev'd*, *Checkosky v. SEC*, 139 F.3d 221 (D.C. Cir. 1998). These types of difficult judgment calls—even if later shown to be wrong—are not within the scope of Rule 102(e)'s heightened negligence standards. 63 Fed. Reg. 57,164, 57,167-68; *Potts*, Exchange Act Rel. No. 39126, 53 SEC Docket 187.

In his audits of Fund III, Mr. Beamish made countless decisions based on his decades of experience and his professional judgment. The Division does not contest that Mr. Beamish's conduct of these audits was faultless in all other respects, and thus this matter

comes down to Mr. Beamish's work on a single issue on a single account: prepaid management fees. As demonstrated above and as will be shown at trial, Mr. Beamish exercised his professional judgment reasonably, and relief under Rule 102(e) is unwarranted.

C. Even If Mr. Beamish's Conduct Failed to Meet the Relevant Professional Standards, Sanctions under 102(e) Would be Inappropriate.

The Division seeks to bar Mr. Beamish from practicing before the Commission—an effective end to his career. This result is not supported by the facts of this case, nor on any sound public policy considerations.[265]

The purpose of Rule 102(e) sanctions is not to punish, but to protect the public from unprofessional conduct by professionals who practice before the Commission and to encourage rigorous compliance with auditing standards in future audits. *McCurdy v. SEC*, 396 F.3d 1258, 1264-65 (D.C. Cir. 2005). For that reason, courts should only impose a sanction against an auditor if it would be in the public interest to do so. No such sanction would be in the public interest here, particularly because the Division is solely proceeding on a theory of negligence. *See Steadman v. SEC*, 603 F.2d 1126, 1140, 1141 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (directing the Commission to consider whether the penalty sought is "in the public interest" and finding that a permanent bar based on isolated negligent violations was a "gross abuse of discretion").

Specifically, six *Steadman* factors apply when considering whether an administrative sanction serves the public interest. They are:

> the egregiousness of the [respondent's] actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his [or her] conduct, and the likelihood that the [respondent's] occupation will present opportunities for future violations.

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[265] *See* Ex. 1129 [Scheck Rep.] at 13-16 (stating that public policy considerations do not support sanctions in this matter).

Id. at 1140; *In the Matter of Steven Altman, Esq.*, Exchange Act Release No. 63306 (Nov. 10, 2010), 99 SEC Docket 34405, 34435, pet. denied, 666 F.3d 1322, 1329 (D.C. Cir. 2011); *Gary M. Kornman*, Advisers Act Release No. 2840 (Feb. 13, 2009), 95 SEC Docket 14246, 14255, pet. denied, 592 F.3d 173 (D.C. Cir. 2010).

Here, all six *Steadman* factors weigh against the imposition of a bar.

First, Mr. Beamish's conduct in the Burrill audits was not egregious and did not involve scienter. In *In re Michael C. Pattison, CPA*, Admin. File No. 3-14323, Initial Decision (Sept. 29, 2011), this Court stated that Respondent Pattison's "*knowing and intentional* misconduct," which involved intentionally understating over $14 million in corporate assets, "was quite serious," but concluded that "the nature of the conduct for which Pattison was found liable was egregious, *but not especially so.*" Order at 9-10 (emphases added); *see also In the Matter of Laurie Bebo and John Buono, CPA*, Admin File No. 3-16293, Initial Decision, 76-77 (Oct. 2, 2015) (finding that intentional deception and abuse of power weighed heavily in favor of sanction because the acts demonstrated "shamelessly egregious behavior" and scienter). Here, the Division does not allege knowing and intentional misconduct, and the audits in question correctly disclosed the prepaid management fees on the face of the audited financials.

Moreover, Mr. Beamish acted in good faith, which—while not an absolute defense under Rule 102(e)(1)(ii)—may be considered when determining whether sanctions would be appropriate. For example, in *In the Matter of Gerard A.M. Oprins, CPA and Wendy McNeeley, CPA*, Admin. File No. 3-13797, Initial Decision, 40 (Dec. 28, 2010), the presiding judge considered the nature of the transactions under *Steadman* when he decided to impose a sanction below what the Division requested for McNeeley after dismissing all charges against Oprins. The judge noted that the transfers in question "were not part of a key audit area typically focused on in audits of private equity funds; the audit team reasonably focused its

attention on a number of higher-priority audit areas. The Transfers did not raise the types of concerns typically associated with related-party transactions, such as artificially inflating the profit or loss of the entity." *Id.* The respondents "reasonably planned the AA Capital engagement and had no indication that AA Capital would be a risky client." *Id.* The same is true here, and should be considered as weighing against a finding of egregiousness. Therefore, the *Steadman* factors of egregiousness and scienter both weigh heavily against imposition of a bar on these facts.

Second, Mr. Beamish's conduct was not recurrent. Instead, the Division challenges one isolated issue and assessment by Mr. Beamish that was carried over into multiple years. In the context of Mr. Beamish's decades-long, spotless career record, the conduct at issue constitutes just one isolated instance, not a protracted scheme spanning multiple engagements or multiple auditing failures in one engagement. *In the Matter of Halpern & Assocs.*, Admin. File No. 3-16399, Initial Decision at 33 (ALJ, Jan. 5, 2016) (in which, notwithstanding "multiple audit failures" that resulted in overstated net capital on financial statements, this Court weighed under *Steadman* the fact that "Respondents' misconduct, while serious, occurred in a single audit [and] Respondents have continued to audit companies since 2009 apparently without incident.").

Third, Mr. Beamish has made sincere assurances against future violations. Mr. Scheck in his expert report relates that "[i]n speaking with Beamish, he is appropriately regretful about this incident and has represented to me that he has and will use this situation as a learning experience for future audits."[266] Mr. Beamish's sincere feelings should be considered in his favor, especially given the lack of scienter or intentional conduct.

As to the last two *Steadman* factors—"the [respondent's] recognition of the wrongful nature of his [or her] conduct, and the likelihood that the respondent's occupation will present

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[266] *See* Ex. 1129 [Scheck Rep.] at 15.

opportunities for future violations"—these factors are neutral. *Steadman*, 603 F.2d at 1140. Mr. Beamish's decision to bring good faith defenses and litigate this question before the Court, thereby asserting his Constitutional rights to defend himself, should not be grounds for penalty. But even though Mr. Beamish vigorously defends himself against the charges, he has repeatedly stated that he regrets the turmoil the limited partners of Fund III suffered. He cares about investors, the integrity of the Commission's processes, and the quality of his audits.[267] As such, the fact that he disputes these charges should not unfairly penalize him under the *Steadman* factors. The same is true of whether his occupation "will present opportunities for future violations." *Steadman*, 603 F.2d at 1140. Mr. Beamish is currently consulting and is not conducting audits, in accordance with PwC policy. He would like to re-engage as an auditor, and if he should return to auditing public companies, the fact that he has no audit quality issues in his record should be considered under this factor.

Beyond *Steadman*, an important factor here is the lack of proved harm to investors. *Marshall E. Melton*, 56 S.E.C. 695, 698 (2003). The Division has produced no evidence whatsoever that investors relied upon the disclosures in question. In *In the Matter of BDO China Dahua CPA Co., Ltd., et al.,* Admin File Nos. 3-14872, 3-15116, Initial Decision (Jan. 22, 2014), this Court noted this non-*Steadman* factor and stated that "the degree of harm to investors and the marketplace is somewhat uncertain." Initial Decision at 109. Here, every limited partner was on notice, for at least 5 years, that the General Partner was receiving payments from the Fund in excess of the annual management fee, and that this prepaid expense balance was growing. None of these sophisticated investors chose to question the information, as was their right under the LPA; when they finally did, they exercised their rights to remove the General Partner and recapture the capital account. Under *Melton*, this

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[267] *See id.*

Court should consider the lack of evidence of harm to investors in favor of denying relief under Rule 102(e).

Mr. Beamish has been an auditor since 1992.[268] He has never been disciplined or found to have violated any professional standards, either by the California Board of Accountants, or by the SEC. *See Oprins/McNeeley* (considering McNeeley's "distinguished career and no disciplinary history" as weighing in favor of lighter sanction). Application of the *Steadman* factors, in light of Mr. Beamish's long record as a competent and careful auditor, coupled with the facts of this case, reveals that a bar would be punitive without serving the public interest. Initial Decision at 40.

VI. Respectfully, this Court Was Not Validly Appointed, Requiring Dismissal of the Action.

"Officers of the United States" must be appointed pursuant to the Appointments Clause. U.S. Const. Art. II, § 2, cl. 2. The presiding ALJ has not been so appointed. Because he is an inferior Officer who was not appointed pursuant to constitutional requirements, the ALJ lacks authority to preside over this hearing, render an initial decision on liability, or impose sanctions on Mr. Beamish.

To determine whether SEC ALJs are Officers, the Supreme Court's decision in *Freytag v. C.I.R.*, 501 U.S. 868 (1991), is instructive. The Court found that special tax judges of the U.S. Tax Court are inferior officers, not employees, based on three characteristics: (1) the position was "established by Law," (2) "the duties, salary, and means of appointment . . . are specified by statute," and (3) the special judges "exercise significant discretion" in "carrying out . . . important functions." *Id.* at 881, 882.

Applying *Freytag*, the Tenth Circuit recently found that SEC ALJs are inferior Officers who must be constitutionally appointed because their position has all three of these

[268] Ex. 1181 [Beamish Dep.] at 14:1-12.

"characteristics." *Bandimere v. Sec. & Exch. Comm'n*, 844 F.3d 1168, 1179 (10th Cir. 2016). Likewise, on February 16, 2017, the D.C. Circuit granted a petition for an *en banc* rehearing of *Raymond J. Lucia Cos. Inc. v. SEC*, 832 F.3d 277 (D.C. Cir. 2016), to address the same constitutional question and reconsider its earlier holding in *Landry v. FDIC*, 204 F.3d 1125 (D.C. Cir. 2000) (finding ALJs of the Federal Deposit Insurance Corp. to be employees, not Officers). Argument in *Lucia* is scheduled for May 24, 2017.

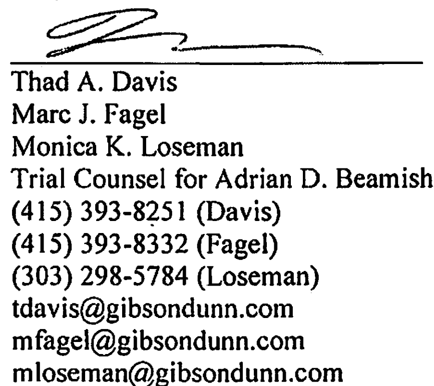
The charges against Mr. Beamish should be dismissed because the present proceedings violate the Constitution. The presiding ALJ in this case is an "Officer" who is not appointed pursuant to constitutional requirements. In the alternative, given the current circuit split, the D.C. Circuit's decision to rehear *Lucia* with an *en banc* panel, and the persuasive application of *Freytag* to this very issue in *Bandimere*, the Court should stay this case pending a final decision in *Lucia*. Mr. Beamish respectfully reserves his right to bring this issue on appeal.

VII. CONCLUSION

For the foregoing reasons, the Division will not be able to meet its burden of proving the charges set forth in the OIP, and the OIP should be dismissed in its entirety.

Dated: April 21, 2017

Respectfully submitted,



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Certificate of Service

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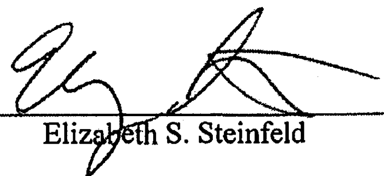
By: 
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