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ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS, AND IMPOSING SANCTIONS

In the Matter of Wander Rodrigues Teles,

Respondent.

PCAOB Release No. 105-2017-007

March 20, 2017

By this Order, the Public Company Accounting Oversight Board ("Board" or "PCAOB") is censuring Wander Rodrigues Teles ("Teles" or "Respondent"); barring Teles from being an associated person of a registered public accounting firm;[1] and imposing a civil money penalty in the amount of $10,000 on Teles. The Board is imposing these sanctions on the basis of its findings that Teles violated PCAOB rules and standards in connection with the audits of the consolidated financial statements of Sara Lee Corporation ("Sara Lee") as of and for the fiscal years ended ("FYE") July 3, 2010 and July 2, 2011.

I.

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

II.

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

[1] Teles may file a petition for Board consent to associate with a registered public accounting firm after two (2) years from the date of this Order.

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consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions ("Order") as set forth below.[2]

III.

On the basis of Respondent's Offer, the Board finds[3] that:

A. Respondent

1. **Teles**, 56, of Sao Paulo, Brazil, is an accountant licensed by the Conselho Regional De Contabilidade for the Federal District of Brazil (license No. DF-005919/O-3). From July 1992 to June 2014, he was a partner of the Brazil-based firm PricewaterhouseCoopers Auditores Independentes ("PwC-Brazil"), which is registered with the Board.[4] Teles was the lead partner for PwC-Brazil's audit work in connection with the audits of Sara Lee's FYE 2007 through FYE 2011 consolidated financial statements. U.S.-based PricewaterhouseCoopers LLP ("PwC-US") prepared and issued the audit reports on Sara Lee's consolidated financial statements, which were filed with the U.S. Securities and Exchange Commission. Teles and PwC-Brazil performed the audit procedures on the special purpose financial information of Sara Lee's Brazilian subsidiaries, which was prepared for Sara Lee's consolidated financial statements, for the express purpose of assisting PwC-US's audits. As the lead partner for PwC-Brazil's audit work, Teles was responsible for supervising the PwC-Brazil engagement team's audit procedures, and for issuing PwC-Brazil's interoffice reports on the Brazilian subsidiaries' special purpose financial information. At all relevant times,

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2 The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

3 The Board finds that Respondent's conduct described in this Order meets the condition set out in Section 105(c)(5) of the Act, which provides that such sanctions may be imposed in the event of: (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

4 While a partner of PwC-Brazil, Teles participated in financial statement audits of issuers (as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii)) in which PwC-Brazil issued the audit report, including issuer audits in which he served as the engagement partner or engagement quality reviewer. Teles also participated in issuer audits where PwC-Brazil performed referred work and another audit firm issued the audit report.

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Teles was an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

B. Issuer

2. **Sara Lee** was, at all relevant times, a Maryland corporation headquartered in Illinois. Sara Lee's common stock was registered with the Commission under Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and was quoted on the Chicago Stock Exchange, New York Stock Exchange, and the London Stock Exchange. At all relevant times, Sara Lee was an issuer, as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii). The company's public filings disclosed that it was a global manufacturer and marketer of consumer products, focused primarily on the meats, bakery, and beverage product categories.

3. **Sara Lee Cafés do Brasil Ltda. ("SLCB")** was, at all relevant times, a Brazilian subsidiary of Sara Lee. SLCB was a producer of roasted coffee and coffee-related consumer goods, which it primarily sold to wholesalers, retailers and retail customers in Brazil.

C. Summary

4. This matter concerns Teles's repeated violations of PCAOB rules and standards[5] as the lead partner for the audit procedures that PwC-Brazil performed under his supervision on SLCB's FYE 2010 and FYE 2011 special purpose financial information. Teles, an experienced audit partner, violated PCAOB rules and standards in connection with PwC-Brazil's testing of SLCB's net accounts receivable ("Net A/R"),

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[5] All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the relevant audits. As of December 31, 2016, the PCAOB reorganized its rules and auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015); see also *PCAOB Auditing Standards Reorganized and Pre Reorganized Numbering* (January 2016), https://pcaobus.org/Standards/Auditing/Documents/PrintableReferenceTable.pdf.

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net revenues, and trade promotions accounts, which were identified as areas having increased risks of material misstatement, including a risk of fraud.[6]

5. Teles knew of red flags suggesting that SLCB's reported Net A/R and net revenues may have been materially overstated, and that its reported trade promotion accounts may have been materially understated, due to SLCB (1) failing to record trade promotions, or (2) failing to record adequate reserves for receivables for which collection was not probable. Teles, however, failed to respond to those red flags and the increased risks with appropriate due professional care and professional skepticism, and failed to obtain sufficient competent evidence concerning those accounts.

6. During both the FY 2010 and FY 2011 Sara Lee audits, Teles knew that a material portion of SLCB's accounts receivable balance was overdue and disputed by customers. As recorded in SLCB's accounting records, approximately 87 million Brazilian reais ("R$") of SLCB's A/R were overdue at both FYE 2010 and FYE 2011 (40% and 36% of those balances, respectively), including approximately R$20 million in receivables more than 90 days overdue (10% and 8% of SLCB's reported A/R balance at FYE 2010 and FYE 2011, respectively). Teles was aware that many of the customers' disputes involved claims that SLCB had failed to recognize trade promotion obligations that should have offset the accounts receivable. Teles also knew that, with very few exceptions, SLCB had not accrued A/R Reserves or trade promotion liabilities to offset the disputed amounts.

7. Teles further knew that SLCB management was re-aging overdue receivables by extending their due dates in SLCB's accounting system. Teles understood that the re-aging of receivables could cause overdue receivables to appear current. Teles therefore knew, or should have known, that an even larger portion of SLCB's receivables was likely overdue than what was shown in SLCB's accounting records. He further understood that the re-aging could cause SLCB to underestimate its A/R Reserves and thereby cause an overstatement of SLCB's reported Net A/R.

8. In light of the information that Teles had and the risks associated with SLCB's Net A/R, net revenues, and trade promotion accounts, Teles failed to exercise due professional care and professional skepticism, and failed to obtain sufficient

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[6] Net A/R consisted of SLCB's gross accounts receivable less reserves for doubtful accounts and sales returns and allowances ("A/R Reserves"). Net revenues consisted of SLCB's gross sales less sales returns and trade promotion costs. SLCB also reported a liability for trade promotions. Trade promotion liabilities were typically satisfied by SLCB crediting the customers' A/R balances.

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competent audit evidence, with regard to those accounts. Among other things, Teles repeatedly failed to address the impact of management's re-aging of SLCB's overdue receivables when planning the audit procedures and evaluating the audit evidence. As a result, Teles and his engagement team improperly relied on SLCB's re-aged A/R data as audit evidence, and failed to obtain other sufficient competent evidence to support Net A/R. Teles also unreasonably assessed the audit risk for trade promotions as "normal" in both audits, contrary to instructions he received for the audits and despite internal control deficiencies at SLCB related to trade promotions. As a result, Teles failed to plan or perform sufficient procedures to respond to the risk of material misstatement from unrecorded trade promotions indicated by the substantial customer disputes.

9. Teles's violations impaired his and the engagement team's ability to detect material misstatements due to error or fraud in SLCB's financial information. As a result of his violations, Teles improperly authorized PwC-Brazil's issuance of interoffice reports on SLCB's special purpose financial information for FY 2010 and FY 2011.

10. In 2012, Sara Lee disclosed that an internal investigation had identified intentional overrides of certain internal controls as well as extensive cross-functional collusion by management of SLCB, resulting in improper revenue recognition and overstatement of accounts receivable due to the failure to write-off uncollectable customer discounts, among other things. As a result of the internal investigation, which included findings indicating fraud, Sara Lee restated its FY 2010 and FY 2011 financial statements and concluded a material weakness existed in internal control over financial reporting as of June 30, 2012. The restatements reflected that, based on the internal investigation, SLCB's Net A/R, as originally reported, was overstated by approximately R$151 million (or 246%) at FYE 2010, and R$170 million (or 263%) at FYE 2011, and that SLCB's total assets, as originally reported, were also overstated by approximately R$102 million (or 14%) and R$121 million (or 15%) at FYE 2010 and FYE 2011, respectively.

D. Background

1. Structure of the Audit

11. PwC-US is a public accounting firm, organized as a Delaware limited liability partnership, and is headquartered in New York, NY. PwC-US is a member of PwC Global network ("PwC Global"), which comprises firms that are members of, or have other connections to, PricewaterhouseCoopers International Ltd. PwC-US is registered with the Board pursuant to Section 102 of the Act and PCAOB rules.

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12. PwC-US served as the independent auditor of Sara Lee's FY 2010 and FY 2011 consolidated financial statements, and issued unqualified audit reports on those financial statements, and on the effectiveness of Sara Lee's internal controls over financial reporting as of those fiscal year ends. In both of those audits, PwC-US relied upon affiliates in the PwC Global network to perform audit procedures concerning specific Sara Lee subsidiaries around the globe. To do so, PwC-US utilized Netherlands-based PricewaterhouseCoopers Accountants N.V. ("PwC-NL") to coordinate and report on the audit procedures performed on Sara Lee's international operations.

13. For both the FY 2010 and FY 2011 audits, PwC-NL instructed PwC-Brazil to perform what it described as an "integrated audit" of SLCB's special purpose financial information, which included both a balance sheet and income statement, using a planning/performance materiality of 2.25 million Euros (approximately R$5 million). PwC-NL further instructed PwC-Brazil to perform its audit work in accordance with PCAOB standards, and to opine on whether SLCB's financial information was presented in accordance with Sara Lee Corporation's Finance Policy Manual ("Sara Lee policies"), which the instructions stated, Sara Lee had "developed . . . in accordance with U.S. GAAP."

14. As the lead partner for PwC-Brazil's audit work, Teles authorized the issuance of PwC-Brazil's interoffice reports on SLCB's special purpose financial information for both the FY 2010 and FY 2011 audits (the "Interoffice Reports"). The FY 2010 and FY 2011 Interoffice Reports, dated August 5, 2010, and August 2, 2011, respectively, stated that PwC-Brazil had audited SLCB's special purpose financial information in accordance with PCAOB auditing standards. Except for certain qualifications that are not relevant to this Order, both Interoffice Reports stated that SLCB's special purpose financial information "has been prepared to give the information required to be shown in accordance with the policies and instructions contained in [Sara Lee's policies]."

15. Teles understood that PwC-NL would rely upon PwC-Brazil's Interoffice Reports to issue its own interoffice reports on consolidated special purpose financial information of Sara Lee's international subsidiaries. Teles further understood that PwC-US would rely upon PwC-NL's interoffice reports in preparing and issuing its audit reports on Sara Lee's consolidated financial statements. And, in fact, PwC-US issued unqualified audit reports on Sara Lee's FY 2010 and FY 2011 financial statements based, in part, on PwC-Brazil's Interoffice Reports.

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2. SLCB's Revenue Recognition, Trade Promotions and Accounts Receivable

16. SLCB earned revenue from the sale of coffee. Customers were primarily large distributors and grocery chains. SLCB provided a variety of sales incentives to its customers, including discounts, promotional credits and other consideration ("trade promotions"). "Key account" customers had written agreements with SLCB,[7] which granted them certain trade promotions. Additionally, salespersons were able to offer temporary trade promotions to both key and non-key account customers.

17. Consistent with U.S. GAAP,[8] Sara Lee policies required that SLCB report its revenues net of its estimated trade promotion costs. SLCB was to record the sale price before any discounts or rebates as gross sales and record the cost of any related trade promotions in contra-revenue accounts.

18. For trade promotions that a customer was immediately entitled to receive as a discount, SLCB was to record accounts receivable net of the trade promotions. For trade promotions that could not be immediately applied to the customer account (e.g., promotions payable on a future date), SLCB was to record accounts receivable based on the gross sale price, while also recording a liability to recognize its obligation to provide the trade promotions. When SLCB's customer became entitled to receive the trade promotions, SLCB would reduce the liability either by paying the customer or offsetting the liability against the accounts receivable.

19. Teles understood that, when an SLCB customer believed it was entitled to a trade promotion, it was common for the customer to take a "self-deduction" to claim the anticipated trade promotion—i.e., the customer would pay the net amount owed after the anticipated trade promotion, rather than paying the gross sales price and waiting for reimbursement. Teles further understood that it was an accepted practice for SLCB customers to use self-deductions to claim the benefit of an agreed-upon trade promotion that had not been reflected in the invoiced amount. Sara Lee policies recognized that customers would claim trade promotions through self-deductions. In such scenarios, assuming that SLCB had properly recorded the trade promotion liability at the time of sale, SLCB was expected to reduce the trade promotion liability established for that sale by the unpaid portion of the gross sales price.

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[7] In contrast to key accounts, non-key accounts were typically smaller accounts for which there were no written master agreements.

[8] See FASB Accounting Standards Codification ("ASC") 605-50, *Revenue Recognition – Customer Payments and Incentives*.

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20. Teles knew that customers also took self-deductions when no specific trade promotion liability had been recorded. This would occur, for example, if a salesperson had agreed to a discount at the time of sale, but SLCB failed to record it. Self-deductions taken when no specific trade promotion liability had been recorded, until resolved, remained a part of SLCB's receivables balance.

21. Teles was aware that many self-deductions were essentially disputed receivables, and raised a risk of non-collectablility. Self-deductions presented a risk that SLCB might not have recorded all of its trade promotions. If SLCB failed to record all of the costs of its trade promotions, its net revenues would be overstated. In addition, accounts receivable would be overstated or the trade promotion liability would be understated.

3. Teles's Knowledge of the Risks and Red Flags

22. Before beginning work on the FY 2010 and FY 2011 audits, Teles became aware of several risks and red flags that should have caused him to heighten his professional skepticism with respect to SLCB's Net A/R, net revenues, and trade promotions. Teles and his engagement team recognized these risks, and documented a "critical matter" for Net A/R in both years.[9]

a. <u>Teles Understood that SLCB was Experiencing Significant Levels of Overdue Receivables</u>

23. At the time of the FY 2010 and FY 2011 audits, Teles knew that SLCB's receivables more than 90 days overdue were significant. SLCB's records indicated that there had been an eleven-fold increase in SLCB's accounts receivable recorded as more than 90 days overdue at FYE 2009. SLCB's records did not indicate significant improvement in the aging of SLCB's receivables at either FYE 2010 or FYE 2011 when compared to FYE 2009.

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[9] A "critical matter," sometimes referred to as a "significant matter," was a defined term in PwC-Brazil's internal guidance. That term referred to significant findings or issues that were important to the procedures performed, evidence obtained, or conclusions reached, within the meaning of Auditing Standard No. 3, *Audit Documentation,* ¶ 12. Under PwC-Brazil policy, Teles was required to be involved in the resolution of critical matters and to review the documentation of the critical matters.

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b. Teles Understood that Significant Overdue Accounts Receivable Were Disputed

24. During the FY 2010 and FY 2011 audits, SLCB management informed Teles that a significant portion of the A/R more than 90 days past due were the result of customers taking self-deductions. Teles understood from his discussions with SLCB management that the customers were taking self-deductions to dispute their obligation to pay the remaining balances, claiming that SLCB owed them trade promotion credits. Management also represented to Teles that the overdue receivables had increased in conjunction with a global financial crisis.

c. Teles Understood that SLCB Was Re-Aging Overdue Accounts Receivable

25. Teles understood that SLCB's accounts receivable, as reflected in SLCB's records, had been re-aged. Before issuing the FY 2010 Interoffice Report, Teles learned from management that SLCB had extended due dates on some of its receivables (including self-deductions) that were the subject of disputes by SLCB's customers.

26. Teles understood that, when SLCB extended due dates, SLCB revised the due dates for the overdue receivables in its A/R subledger, the basis for which Teles did not test.[10] Teles also understood that changes to the due dates of receivables in the A/R subledger would cause the receivables to appear less overdue, and possibly current. As a result, Teles knew, or should have known, that any analyses of the A/R aging prepared from the A/R subledger would depict the receivables as less-aged than they really were.

d. SLCB Had Identified Internal Control Deficiencies Concerning Net A/R, Net Revenues and Trade Promotion Accounts

27. Teles knew, or should have known, that the Sara Lee internal audit function ("Internal Audit") had identified internal control deficiencies related to SLCB's Net A/R, net revenues and trade promotion accounts. During the FY 2009 audit, Teles received access to an internal audit report ("2009 IA Report") that indicated that there had been several deficiencies in SLCB's internal controls, which could cause misstatements in SLCB's Net A/R, net revenues and trade promotion accounts.

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[10] Management represented to Teles that it had extended due dates based on negotiations with SLCB's customers.

Although SLCB purported to have taken steps to address those deficiencies, Teles received access to another IA Report in mid-FY 2010 ("2010 IA Report"), which noted several similar deficiencies.[11]

e. <u>Teles Understood that there Were Audit Risks, Including a Risk of Material Misstatement Due to Fraud, Associated with SLCB's Net A/R, Net Revenues and Trade Promotions</u>

28. For both the FY 2010 and FY 2011 audits, PwC-NL advised Teles and his PwC-Brazil engagement team that there were increased audit risks relating to Net A/R, net revenues and trade promotions. In addition, in both years, Teles understood that there were risks of material misstatement due to fraud related to those accounts. Among other things, the disputes between SLCB and its customers raised a major concern for Teles about whether the recorded accounts receivable balance was accurate. That concern was documented, in part, in the FY 2010 and FY 2011 "critical matter" work papers.

29. In both years, PwC-NL's audit instructions indicated that it was unlikely that evidence from controls and substantive analytical procedures alone would be sufficient to address the risks identified for revenue and trade promotions, and that tests of details were typically necessary to address such risks.

E. Applicable PCAOB Standards During the FY 2010 and FY 2011 Audits

30. In connection with the preparation or issuance of an audit report, PCAOB rules require that registered public accounting firms and their associated persons comply with applicable auditing and related professional practice standards.[12] As the lead partner for PwC-Brazil's audit work on SLCB's special purpose financial information, Teles had an obligation under PCAOB standards to supervise the audit and

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[11] The 2010 IA Report indicated that the deficiencies were "important strategic, financial, compliance or operational issue[s] for the operating company." It also indicated that "[t]he related risk[s] ha[ve] mitigating controls in place and/or the likelihood of having a significant effect on the operating company is small."

[12] <u>See</u> PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

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to obtain "sufficient competent evidential matter."[13] To be competent, audit evidence must be both valid and relevant.[14]

31. Teles was required to plan PwC-Brazil's audit procedures based on assessments of both audit risk and materiality.[15] Although an audit client's internal controls could impact the assessment of audit risk, a determination that audit risk was lower due to the client's internal controls was required to be based on an assessment of both those controls' design and effectiveness.[16] Additionally, Teles and his engagement team needed to perform substantive tests for all relevant assertions related to all significant accounts, regardless of assessed level of control risk.[17]

32. Teles was required to perform his work with due professional care, which, in turn, required him to exercise professional skepticism.[18] Teles also was required "to be thorough in his . . . search for evidential matter," to be "unbiased in its evaluation," and to consider relevant evidential matter regardless of whether it appeared to corroborate or to contradict the assertions in SLCB's financial information.[19] Teles could not be satisfied with less-than-persuasive evidence because of a belief that management was honest.[20]

33. Teles should have conducted PwC-Brazil's audit procedures "with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of [his] belief about management's honesty and integrity."[21] To ensure that the risks of material misstatement due to fraud were appropriately identified and assessed, Teles was required to consider how and where SLCB's financial information might be susceptible

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13 See AU § 311, *Planning and Supervision*; AU § 326.22, *Evidential Matter*.

14 See AU § 326.21.

15 See AU § 312, *Audit Risk and Materiality in Conducting an Audit*.

16 See AU §§ 319.03, .66, .80-.81, .86, *Consideration of Internal Control in a Financial Statement Audit.*

17 See AU § 319.107.

18 See AU §§ 230.02, .07, *Due Professional Care in the Performance of Work*.

19 See AU § 326.25.

20 See AU § 316.13, *Consideration of Fraud in a Financial Statement Audit*.

21 See AU § 316.13.

to material misstatement due to fraud, and how management could perpetrate and conceal fraudulent financial reporting.[22] To do so, Teles should have considered whether there were accounts or classes of transactions that may have been susceptible to manipulation by management.[23] In particular, PCAOB standards instructed that Teles should have presumed a risk of material misstatement due to fraud relating to revenue recognition,[24] and PCAOB standards also warned that "[f]raudulent financial reporting often is accomplished through intentional misstatements of accounting estimates."[25] Teles also should have considered whether there were "fraud risk factors" present,[26] including deficiencies in internal controls that increased the opportunity for fraud.[27]

34. Teles was also responsible for ensuring that the procedures performed by the engagement team adequately addressed the identified risks of material misstatement due to fraud.[28] The response to risks of material misstatement due to fraud should have included application of professional skepticism in gathering and evaluating audit evidence, including critical assessment of the competency and sufficiency of the audit evidence.[29] PCAOB standards required Teles to thoroughly probe the issues of potential fraud, and acquire additional evidence as necessary, rather than rationalize or dismiss information or other conditions that indicated a material misstatement due to fraud may have occurred.[30]

35. As detailed, below, Teles violated these and other PCAOB standards in both the FY 2010 and FY 2011 audits.

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[22] See AU §§ 316.14, .34.

[23] See AU § 316.39.

[24] See AU § 316.41.

[25] See AU § 316.63.

[26] See AU §§ 316.31-33.

[27] See AU § 316.85.

[28] See AU § 311.13; AU § 326.25; AU § 316.02, .46, .48(b), .51-.56.

[29] See AU § 316.46.

[30] See AU § 316.16.

F. Teles Violated PCAOB Rules and Standards

36. Teles violated PCAOB standards during the FY 2010 and FY 2011 audits because he failed to appropriately plan and supervise PwC-Brazil's audit procedures with due professional care and professional skepticism. He further failed to ensure that the engagement team adequately responded to the risks of material misstatement, including risks of material misstatement due to fraud, and red flags for SLCB's Net A/R, net revenues and trade promotion accounts. As a result, he failed to obtain sufficient competent audit evidence.

37. Teles determined that, in light of the risks described above, he should be directly involved in, and review, the work performed over SLCB's accounts receivable, and he designated SLCB's Net A/R a "critical matter." Nevertheless, he failed to ensure that PwC-Brazil adequately responded to the identified risks and red flags related to SLCB's Net A/R.[31] For audit procedures that his engagement team did perform, he failed to consider whether the audit evidence obtained to support SLCB's reported Net A/R was relevant or reliable, in light of SLCB's re-aging of receivables. He also failed to sufficiently address contradictory evidence obtained by the engagement team concerning Net A/R.[32]

38. Moreover, although Teles was aware of the risks relating to trade promotions, he inappropriately determined to treat trade promotions as a normal risk. As a result, he failed to plan or perform procedures beyond control testing and analytical procedures to address trade promotions. And the procedures that the engagement team did perform failed to address the risk that all of SLCB's trade promotions were not recorded.

1. Teles's Failures Concerning SLCB's Net A/R

39. When planning PwC-Brazil's FY 2010 and FY 2011 audit procedures for SLCB, Teles inappropriately determined to place high reliance on SLCB's internal controls and analytical procedures, and to reduce the extent of substantive testing for Net A/R. Besides performing tests of internal controls and analytical procedures, PwC-Brazil's principal audit procedures for Net A/R in FY 2010 consisted of: (1) attempting to confirm a sample of receivables and performing alternative procedures for nonresponses to confirmation requests, (2) reviewing SLCB's A/R aging and A/R Reserves for doubtful accounts, and (3) reviewing bad debt write-offs. For the FY 2011

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[31] See AU § 312; AU § 316.

[32] See AU § 326.25.

audit, despite the continuing risks surrounding Net A/R, Teles and his engagement team eliminated the confirmation procedures, including alternative procedures for non-responses, and review of bad debt write-offs, and relied principally on the review of SLCB's A/R aging and A/R Reserves.

40. The procedures performed, however, were inadequate to respond to the risk that SLCB was re-aging and otherwise delaying the write-off or reserving of uncollectable receivables.

41. Teles failed to identify and address the deficiencies in PwC-Brazil's planned procedures, their execution, or the evidence that they produced. He failed to appropriately supervise and review the engagement team's performance of those procedures. As a result, Teles failed to exercise due professional care and professional skepticism, and failed to obtain sufficient competent evidence to support that SLCB's Net A/R existed and was appropriately valued.

a. <u>Teles and His Team Failed to Appropriately Perform Confirmation and Alternative Procedures on SLCB's Receivables</u>

FY 2010

42. Under PCAOB standards, it is presumed that an auditor will request confirmation of accounts receivable,[33] and PwC-NL explicitly requested that PwC-Brazil confirm accounts receivable for the FY 2010 audit. PwC-Brazil accordingly planned to perform confirmation procedures for A/R and alternative procedures for nonresponses, including tracing the receivables to subsequent cash receipts.[34]

43. Despite the importance of the confirmation and alternative procedures, Teles failed to appropriately supervise those procedures, or evaluate their results with due professional care. PwC-Brazil's confirmation testing and alternative procedures

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[33] <u>See</u> AU § 330.34, *The Confirmation Process*.

[34] PCAOB standards provide that "[t]he nature of alternative procedures varies according to the account and assertion in question." AU § 330.32. They also provide that "[i]n he examination of accounts receivable, for example, alternative procedures may include examination of subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documents, or other client documentation to provide evidence for the existence assertion." <u>Id.</u>

were performed on a non-representative sample of ten receivables.[35] Additionally, those procedures were not performed with due professional care, and did not address contradictory evidence. As a result, they did not provide sufficient competent evidence to support either the existence or value of SLCB's FYE 2010 accounts receivable.

44. PCAOB standards provide that, in order to obtain relevant audit evidence about a population of transactions through a test of details performed on a sample of transactions, a sample should be designed so that it is reasonably expected to be representative of that larger population.[36] However, the engagement team failed to select a representative sample of receivables for its confirmations and alternative procedures, and instead made a targeted selection of ten very large receivables from those that SLCB had marked "current." Other receivables in the A/R population did not have an opportunity for selection.[37] Accordingly, the results of the test could not be extrapolated to the entire A/R balance, including the population of high-risk overdue receivables for FY 2010. However, because Teles did not appropriately supervise the confirmation testing, he was not aware that his team had restricted that testing to "current" receivables.

45. Teles's failure to appropriately supervise the confirmation and alternative procedures also resulted in the engagement team failing to appropriately respond to contradictory evidence obtained through the alternative procedures. When positive confirmation procedures are performed, but no replies are received, the auditor should apply alternative procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level.[38]

46. PwC-Brazil did not receive any responses from customers confirming the receivables, which was consistent with the engagement team's experience on the prior year's audit and Teles's experience in Brazil, generally. PwC-Brazil attempted to apply alternative procedures for the receivables not confirmed by examining subsequent cash receipts for the selected receivables. However only two of the ten receivables tested for subsequent cash receipts were matched to a cash receipt of equal value to the

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[35] The confirmation and alternative procedures were performed on a selection of just ten current receivables from SLCB's May 31, 2010 A/R balance. That selection covered just 2.4% of the total value of the May 31, 2010 A/R balance, which was comprised of more than 32,000 receivables totaling R$205.8 million.

[36] See AU §§ 350.16-.17, .24, *Audit Sampling*.

[37] See AU § 350.39.

[38] See AU § 330.31.

receivable. For three other receivables, SLCB provided PwC-Brazil with information indicating that SLCB had received cash, but the amounts of the cash it received were different from the amounts of the receivables. PwC-Brazil did not obtain any evidence that the customers had designated the cash for the receivables it was testing, nor did it perform any procedures to test whether the cash receipts had been appropriately applied.[39]

47. For the remaining five receivables, PwC-Brazil did not obtain evidence of cash being subsequently received by SLCB. PwC-Brazil did, however, receive information that three of those receivables (totaling 18% of the tested value) had been subsequently reversed by applying credit memos for trade promotions. Such information alone did not provide audit evidence that the receivables were valid. In particular, the relative magnitude of the receivables reversed through credit memos within PwC-Brazil's selection should have garnered additional attention from Teles.

48. At the end of the FY 2010 audit work, Teles signed-off that the engagement team had properly performed accounts receivable confirmation testing and alternative procedures. However, before doing so, Teles failed to properly evaluate the evidence obtained, including contradictory audit evidence that cast doubt on whether A/R Reserves and/or trade promotion liabilities had been appropriately recorded to prevent misstatements of SLCB's special purpose financial information.

FY 2011

49. For the FY 2011 audit, Teles and his engagement team did not perform any confirmation or alternative procedures for A/R. Teles and the engagement team documented that they decided to forego confirmation of A/R with SLCB's customers, based on the prior year's poor response rate. Although an auditor may choose to forego confirmation of accounts receivable where the use of confirmations would be ineffective,[40] PwC-Brazil was still required to obtain sufficient competent evidence concerning the existence and value of accounts receivable, a significant account, through substantive testing,[41] and neither Teles nor his engagement team recorded the reason for eliminating the subsequent cash receipts testing they had performed the prior

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[39] As reflected in AU § 330.32, examination of subsequent cash receipts as an alternative procedure for receivables confirmations typically includes "matching such receipts with the actual items being paid."

[40] See AU § 330.34.

[41] See AU § 319.107.

year. Nor did Teles or his team devise or carry out any other alternative procedures to test SLCB's A/R as of FYE 2011.

b. Teles's and His Team's Analysis of Receivables' History, Aging, Collectability and Bad Debt Write-Offs Was Flawed

50. For both FYE 2010 and FYE 2011, Teles and his engagement team planned to respond to the risks indicated by the customer disputes and overdue receivables by testing the reasonableness of management's estimated A/R Reserves for doubtful accounts. PwC-Brazil's procedures to evaluate the reasonableness of the A/R Reserve for doubtful accounts included recalculating the aging of SLCB's A/R by using aging data in SLCB's A/R subledger, and holding discussions with management about customers with large overdue balances. The procedures also included examining period-to-period changes in the age of receivables balances. That testing, however, was flawed because it ignored the impact of SLCB's re-aging of receivables and placed undue reliance on management representations that were contradicted by other information.

51. Teles knew that there was an elevated risk that Net A/R was materially overstated with uncollectable receivables and amounts that should have been offset by trade promotion credits. Teles also understood that a material portion of SLCB's reported A/R more than 90 days overdue were disputed by SLCB's customers, and therefore raised the risk of uncollectability. Teles also should have realized that the disputed receivables, and thus the potential for overstatement of Net A/R, were not confined to those A/R that were recorded as being more than 90 days overdue, since he knew SLCB had been re-aging some overdue A/R that had been the subject of disputes.

52. Under PCAOB standards, Teles needed to assess the reliability of SLCB's A/R subledger data, before he could use that data to evaluate the reasonableness of SLCB's estimated A/R Reserves.[42] Nevertheless, Teles failed to make an appropriate assessment of the reliability of that data. Teles never sought to have his engagement team determine the extent and impact of the re-aging, nor did he seek to quantify the amounts in dispute. Had he done so, data already contained in PwC-Brazil's work papers would have allowed Teles and his engagement team to observe that SLCB's FYE 2010 and FYE 2011 receivables balances had been significantly re-aged.

[42] See AU §§ 342.04, .09-.12, *Auditing Accounting Estimates*.

53. PwC-Brazil's review of SLCB's bad debt write-offs was also compromised by the practice of re-aging, and that review provided insufficient evidence as to the reasonableness of A/R Reserves. That review did not take into consideration that uncollectable receivables, if re-aged, might persist in the A/R balance without being written-off as bad debts. Without evidence to support that all bad debts were being timely written off, this procedure could not provide competent evidence to support the reasonableness of the A/R Reserves.

54. Because the aging analysis and the bad debt write-off review both failed to yield audit evidence that was either relevant or reliable, PwC-Brazil's substantive testing of the AR Reserve for doubtful accounts amounted to little more than management inquiry about the collectability of SLCB's A/R. In both FY 2010 and FY 2011, Teles and the engagement team made inquiries to various members of SLCB's management, including SLCB's CFO, about the overdue receivables. Teles and the engagement team received representations that SLCB was pursuing the overdue receivables and that management believed SLCB would be successful in collecting them.[43]

55. However, management inquiry, alone, could not provide sufficient competent evidence as to the collectability of A/R or the reasonableness of the A/R Reserves. Although management representations "are part of the evidential matter the independent auditor obtains, . . . they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit."[44] In particular, "[i]f a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made."[45]

56. Teles failed to obtain evidence to corroborate management's representations. Teles should have sought additional evidence to corroborate management's representations, particularly because the claims by SLCB customers that they were owed additional trade promotions constituted contradictory evidence as to the existence and value of the overdue receivables, and as to the adequacy of SLCB's related estimates for its A/R Reserves. .

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43 Sara Lee's internal investigation indicated that SLCB management did not accurately represent the circumstances surrounding the receivables.

44 See AU § 333.02, *Management Representations*.

45 See AU § 333.04.

ORDER

57. At the request of Teles and the engagement team, management also presented the engagement team with management's own analyses of changes in the aging of the receivables from period-to-period, but those analyses (like the ones prepared by PwC-Brazil) were based on altered due dates.

c. PwC-Brazil's Control Testing and Analytical Procedures Did Not Provide Sufficient Competent Audit Evidence to Respond to the Elevated Risk of Material Misstatement for Net A/R

58. During the FYE 2010 and FYE 2011 audits, Teles placed significant reliance on SLCB's internal controls to substantially reduce the level of substantive testing for Net A/R. That reliance was unreasonable for the following reasons:

a. Teles had direct knowledge that SLCB was re-aging overdue receivables, and did not test the basis for the re-aging.

b. PwC-Brazil's test of the control for estimating the A/R Reserves for doubtful accounts only examined whether the calculation was being performed and reviewed.

c. As highlighted by the 2009 and 2010 IA Reports, some of SLCB's revenue and receivables were recorded during a period when Internal Audit had identified deficiencies in related internal controls.

59. Although Teles relied on control testing related to sales transactions, those tests did not provide sufficient competent evidence to support the existence or valuation of accounts receivable at either fiscal year-end. In the FY 2010 control test the engagement team selected 25 sales transactions and sought to verify the existence of (1) an invoice, (2) an inventory picking list, (3) a delivery confirmation slip, and (4) a subsequent payment. When performing the same control test in FY 2011, the engagement team selected 45 sales transactions, but failed to seek evidence of subsequent payment. Although the engagement team obtained evidence indicating that the shipments had occurred and/or been delivered, the engagement team did not perform procedures to test whether the receivables had been correctly recorded or appropriately credited.

60. Teles also relied on PwC-Brazil's analytical procedures for A/R, but those procedures did not provide substantive audit evidence to overcome the deficiencies in PwC-Brazil's other Net A/R testing. The analytical procedures could not provide the high level of assurance needed to address the elevated risk and fraud risk associated with A/R. Among other things, PwC-Brazil's expectation was not precise enough to

provide a high level of assurance, because it was based on overall changes to total revenue and A/R, and not disaggregated (e.g., by customer or customer type).[46]

2. Teles's Failures Concerning Net Revenues and Trade Promotions

61. Teles also violated PCAOB standards by failing to appropriately plan and supervise his team's testing of trade promotions with due professional care and professional skepticism, in light of the red flags and risks associated with trade promotions. As a result of those failures, Teles and the engagement team failed to appropriately assess the reasonableness of the trade promotion estimates. And they failed to obtain sufficient competent audit evidence that SLCB had appropriately recorded its obligations relating to trade promotions.

62. SLCB's trade promotion accounts were significant accounts and were susceptible to fraud risks. SLCB's recorded trade promotion costs totaled R$320 million in FY 2010 and R$639 million in FY 2011, and comprised a significant component of SLCB's net revenues. As a constituent part of SLCB's revenue, there was a presumptive fraud risk for trade promotion costs.

63. In both FY 2010 and 2011, PwC-Brazil also identified in its work papers that SLCB's trade promotion liability was a significant management estimate for which there was a risk of fraud. As Teles was aware, by FYE 2010, SLCB's trade promotion liability had been almost entirely exhausted. And although the trade promotion liability balance had increased to R$5.9 million as of FYE 2011, it was still relatively low in light of the volume of SLCB's trade promotion activity and customer disputes over trade promotions.

64. During both FY 2010 and 2011, there were also multiple indications that there was an increased risk of material understatement in SLCB's trade promotion accounts, which should have caused Teles to expand the testing of trade promotions. For example, Teles knew that SLCB's management attributed much of the A/R more than 90 days past due to customer disputes and claims that they were owed additional trade promotions. Further, during the FY 2010 audit, Teles was provided with information demonstrating that SLCB's FYE 2010 trade promotion liability balance of just R$1.1 million was more than R$13 million below its budgeted amount. PwC-NL's instructions for the audits also indicated that trade promotions were a "key" risk in FY 2010 and an "elevated" risk in FY 2011.

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[46] See AU § 329.14, .17-.19, *Analytical Procedures*.

ORDER

65. Nevertheless, Teles changed PwC-NL's risk assessment for trade promotions, and decided that the audit risk for SLCB's trade promotion accounts was normal. Teles decided that PwC-Brazil would seek a low level of assurance from its substantive testing for those accounts and would evaluate trade promotions through a combination of control testing and analytical procedures. Teles also permitted the engagement team to forego several of the procedures that were identified as part of the planned response to the risk of fraud for the trade promotion liability, including retrospective review of the trade promotion liability estimate. Moreover, despite PwC-NL's instructions specifically identifying a high risk to completeness and accuracy of revenue related to trade promotions, Teles failed to ensure that PwC-Brazil's testing adequately addressed these assertions for trade promotions.

66. Teles's decision to reduce the assessed risk for trade promotions was unreasonable, and demonstrates his failure to exercise due professional care and professional skepticism. Teles did not document the reason for his lower trade promotions risk assessment, and nothing in the circumstances of SLCB supported that risk assessment. Indeed, Teles should have considered that the disputes between SLCB and its customers indicated an increased risk that SLCB may have failed to record all trade promotions, and therefore may have materially understated its trade promotion costs and related trade promotion liability, and overstated its net revenues. Likewise, the re-aging of the disputed receivables and the history of adverse findings in the IA Reports relating to trade promotion controls should have caused Teles to perform additional procedures and obtain additional audit evidence during the FY 2010 and FY 2011 audits.

67. In light of the actual audit risks surrounding SLCB's trade promotions, Teles's decision to restrict the trade promotion testing to certain tests of controls and analytical procedures violated PCAOB auditing standards,[47] as did his decision not to perform planned retrospective reviews of the trade promotion liability.[48] PwC-Brazil's control tests and analytical procedures were neither designed nor executed to provide the level of assurance for substantive testing necessary to address the increased risk of misstatement, including for fraud, in trade promotions. The nature, timing and extent of the control tests—including the small number of occurrences and transactions tested—were too limited to provide sufficient competent evidence as to whether all trade

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[47] See AU § 319.107; AU § 329.09; AU § 316.51; see also AU § 316.41.

[48] See AU § 316.64 (the auditor should perform a retrospective review of significant accounting estimates reflected in the financial statements of the prior year to determine whether management judgments and assumptions relating to the estimates indicate a possible bias on the part of management).

promotion costs were appropriately recorded.[49] Also, the tested controls failed to address the risk that SLCB's trade promotions could be understated because of failures to record liabilities and reserves for agreed-upon trade promotions and other incentives/concessions. And the analytical procedures performed by PwC-Brazil did not serve to provide a high level of assurance, because they did not employ any detailed expectation based on a plausible relationship.[50]

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Wander Rodrigues Teles is hereby censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Wander Rodrigues Teles is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);[51] and

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[49] See AU § 350.44.

[50] See AU § 329.14 (as higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation); AU § 329.17 ("The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate.").

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

ORDER

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

D. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $10,000 is imposed upon Wander Rodrigues Teles. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Respondent shall pay the civil money penalty imposed within ten (10) days of the issuance of this Order by (1) wire transfer pursuant to instructions provided by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter that identifies Teles as a respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of said cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

March 20, 2017