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Auditors' Duty to Implement Subsequent Events Procedures for Stock Registration Statements: A Case Study of *In Re Pareteum Securities Litigation*

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ABSTRACT: This is a case study of *In re Pareteum Securities Litigation*, a federal class action lawsuit filed in New York City on February 26, 2020. The plaintiffs consist of the group of stockholders who purchased Pareteum Corporation's (Pareteum) stock during the period of December 14, 2017 through October 21, 2019. During this period, Pareteum significantly overstated its revenue but Pareteum's auditor, Squar Milner (auditor), issued unqualified opinions on Pareteum's financial statements. The defendants are: Pareteum Corporation, several of Pareteum's top managers, and Pareteum's auditor. The case is ongoing and a final judgment has not been entered in this litigation. After the case was filed, the defendants filed motions to dismiss. The court denied the motions to dismiss the case, and the court meticulously explained why the defendants' motions were denied. The specific issues addressed include: (a) the elements of several types of securities fraud pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934; (b) the heightened pleading standards for securities fraud claims created by the Private Securities Litigation Reform Act; (c) in a Securities Act claim against an auditor, whether scienter is required to be proven; (d) whether an auditor's opinion may be construed as a guarantee; (e) whether an auditor's unqualified opinion of the fairness of the financial statements, coupled with the subsequent discovery of fraud, may be actionable against the auditor; (f) the inconsistency of an auditor's issuance of an unqualified opinion on financial statements while simultaneously issuing an adverse opinion on internal control; (g) the auditor's duty to adhere to Auditing Standard 4101, which mandates an auditor to carry out subsequent event procedures; and (h) implications for auditors emanating from this case.

KEY WORDS: auditor, duty, securities fraud, overstated revenue, subsequent event procedures, registration statement

1. General Problem

The problem in this article is to study the legal case of *In re Pareteum Securities Litigation* and to note the court's common law adoptions of Generally Accepted Auditing Standards (GAAS). This legal case was chosen for study because of the court's reliance upon GAAS in its decision-making. Whenever courts refer to GAAS in making their decisions, this confers more legitimacy upon GAAS and reinforces its utilization as a source of authority in future audits.

2. Review of the Literature: Auditor's Duty to Disclose Subsequent Events

Using the case study method, Collings (2012) analyzed financial reporting requirements of auditors, and how an auditor can ensure that all events occurring between the reporting date and the expected date of the auditor's report have been adequately taken into consideration and sufficient appropriate audit evidence has been gathered to achieve the objectives. Al Zoubi (2012) researched accounting academics and investors' perceptions on the adequacy of the quality and quantity of disclosed information by Jordanian publicly-traded firms listed on the Amman Stock Exchange; he found that both groups believed that the quality of disclosure was adequate, but the groups differed on whether the quantity of information was sufficient, with investors perceiving that the quality of information was insufficient. Lai (2013) examined the impact of the fair value measurement on audit quality and determined it has a negative effect on audit quality, and recommended that fair value measurement should be only moderately used in the current stage. In a case study of 62 companies, Hategan (2018) researched the theoretical and legal basis which regulates the accounting and audit of subsequent events; financial statements, audit reports and subsequent events were analyzed and the researcher concluded that reporting of subsequent events is influenced by several factors: category of auditor, the audit opinion, and the performance and size of the firm. In a study of 60 companies, Crucean (2021) emphasized the importance of reporting on subsequent events caused by the Covid-19 pandemic, how the pandemic affected the firms' ability to continue as a going concern, and the impact of the pandemic on the quality of audit services. da Silva (2021) studied ten travel and leisure companies' additional disclosures made

because of the Covid-19 pandemic; although the International Financial Reporting Standards provide no specific guidance on pandemic reporting, the study's findings reveal the companies took utmost care in disclosing information on the impact on Covid-19 in the financial statements.

Missing from the literature is a study of a recent legal case covering an auditor's duty to carry out subsequent events procedures and to disclose recent events and related information that may have a bearing upon an investors' decision to purchase the client's stock. That is the major issue in this case and this study will enrich the literature.

3. Specific Objectives

The objectives of this article are to explain: (a) the elements of several types of securities fraud pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934; (b) the heightened pleading standards for securities fraud claims created by the Private Securities Litigation Reform Act; (c) in a Securities Act claim against an auditor, whether scienter is required to be proven; (d) whether an auditor's opinion may be construed as a guarantee; (e) whether an auditor's unqualified opinion of the fairness of the financial statements, coupled with the subsequent discovery of fraud, may be actionable against the auditor; (f) the inconsistency of an auditor's issuance of an unqualified opinion on financial statements while simultaneously issuing an adverse opinion on internal control; (g) the auditor's duty to adhere to Auditing Standard 4101, which mandates an auditor to carry out subsequent event procedures; and (h) implications for auditors emanating from this case.

4. Background

Pareteum, Inc. is a telecommunications software services provider whose primary target market is mobile virtual network operators, which provide wireless communications to customers, but do not own network infrastructure or create their own software. Until 2015, the company was an unsuccessful penny stock. In late 2015, the firm was restructured and a new Chairman and a new CEO were hired. Over the next three years, several more top managers were recruited (Pareteum case, pp. 5-6).

At some point during 2015-2018, the firm changed its revenue reporting method and began to use a "36-month contractual revenue backlog metric." Although this was described as a "non-GAAP indicative number," the company contended that it was a useful "key performance indicator directly connected to our financial and operating results" and "the value of new sales orders intake and the revenue under contract." The firm began to frequently report the backlog, emphasize its reliability, and stated it was converting into incremental monthly revenue at or above 100%. Plaintiffs alleged that the backlog's value was materially and artificially inflated, and it was not converting to revenue at or above 100%. After several stock market analysts issued letters in mid-2019 which were highly critical of the backlog metric as a predictor of revenue, the company stopped using this metric on August 6, 2019 (Pareteum case, pp. 6-7, 23-27).

During the period of time that the class of stockholders is defined, the firm reported a revenue increase from $4.1 million to $34.1 million, the backlog increased from $200 million to $1.27 billion, and the price of each common share increased from a low of 72 cents per share to a high of $5.93 per share. Beginning in 2018, the firm issued numerous press releases announcing increasing revenue. On May 7, 2018, Pareteum announced record quarterly results, with revenues of $4.1 million, up 47% year-over-year. On August 6, 2018, the company reported another record of quarterly revenue at $6 million, up 85% year-over-year. During September and October of 2018, Pareteum reported $134 million in new contracts. On November 7, 2018, $8 million of quarterly revenue was announced. On March 12, 2019, the firm issued revenue guidance for the coming year at a 225-260% increase year-over-year. As a result of this heady announcement, Pareteum's stock price surged, increasing from $3.91 per share on March 12, 2019 to $5.15 per share on March 13, 2019 (Pareteum case, pp. 7-10).

On March 18, 2019, Pareteum filed its Form 10-K for the fiscal year 2018 with the SEC. In the 10-K, the company admitted that, throughout all of 2018, the company had experienced material weaknesses in its internal control over financial reporting. As a result, the firm stated that its disclosure controls and procedures were ineffective at the end of 2018. Additionally, the following deficiencies were noted: (1) inadequate and ineffective management assessment of internal control over financial reporting, including insufficient experienced resources to document the internal control system; and (2) ineffective design, implementation and monitoring of information technology general controls pertaining to the firm's change management process (Pareteum case, pp. 10-11).

Despite the material weaknesses and the adverse internal control evaluation, the firm contended that its financial statements did not contain any material misstatements and there was no need for any restatement of previous issued statements. Accordingly, the auditor issued an unqualified opinion on Pareteum's financial statements for the year ending December 31, 2018. The Form 10-K for the 2018 fiscal year stated that Pareteum had begun taking measures to alleviate the material weaknesses in the internal controls, and that these measures were expected to correct the weaknesses by the end of 2019. The Form 10-K briefly noted that the auditor had issued an unqualified opinion on the financial statements, notwithstanding the fact that the auditor had also issued an adverse opinion in its evaluation of internal

controls. In defense of this inconsistency, the company stated that it had performed additional analysis and other post-closing procedures to ensure that its financial statements were prepared in accordance with GAAP. The company also reiterated its commitment to maintaining a strong internal control environment. On November 12, 2018, the firm announced an agreement to buy iPass, Inc. (iPass) in an all-stock tender offer, in which Pareteum issued 10 million shares of its stock to the shareholders of iPass. The tender offer was completed, and the acquisition closed on February 12, 2019. In relation to the iPass acquisition, Pareteum filed numerous forms with the SEC, which incorporated Pareteum's financial information (Pareteum case, pp. 10-14). On February 26, 2019, Pareteum secured a $50 million credit facility from Post Road Group. On the same day, Pareteum drew down $25 million from the facility. On August 23, 2019, Pareteum reported that it had been in default, and admitted to eleven breaches, including (1) failing to make its first interest payment, due March 31, 2019; and (2) failing to provide its financial statements to Post Road Group; and (3) failing to obtain and timely deliver consents required to access the $25 million remaining in the facility. To obtain further financing and a waiver of the breaches, Pareteum issued 750,000 shares to stock to Post Road Group. Later in August, Pareteum announced it was selling up to 1,311,439 additional shares to settle debts owed to suppliers. After these disclosures, Pareteum's stock price plummeted from $3.00 per share on August 23, 2019 to $2.00 per share on August 26, 2019. Nevertheless, Pareteum touted its ambitious growth strategies for the current quarter and beyond (Pareteum case, pp. 14-15).

On September 20, 2019, the firm closed a $40 million public offering of common stock and warrants (secondary offering). The secondary offering was registered for sale pursuant to a November 30, 2018 Amended Registration Statement, a December 18, 2018 Prospectus, and a September 20, 2019 Supplemental Prospectus. The secondary offering caused the stock price to decline to $1.50 per share. But the hemorrhaging of the stock price was far from over. **On October 21, 2019, Pareteum issued a press release disclosing: (1) the company would restate its financial statements for 2018 and the first half of 2019; (2) its opinion that investors should no longer rely upon the firm's previously issued financial statements and related communiques for those periods; (3) that certain revenues recognized in 2018 and 2019 should not have been recorded; and for certain customer transactions, the firm may have prematurely or inaccurately recognized revenue; and (4) the estimated revenue reduction for 2018 and the first half of 2019 would be approximately $9 million and $24 million, respectively. Following this announcement, Pareteum's stock price dropped to 37 cents per share on October 22, 2019 and the stock was de-listed from Nasdaq.** In late 2019, multiple class-action lawsuits were filed against Pareteum, its officers and directors, and the auditor; those lawsuits were consolidated on January 10, 2020 (Pareteum case, pp. 28-33, emphasis added).

5. What are the elements of a case of securities fraud pursuant to the Exchange Act?

In the aftermath of the stock market crash of 1929 and the Great Depression which followed, two U.S. federal statutes were enacted pertinent to regulation of the sale of securities on stock exchanges: the Securities Act of 1933 (Securities Act) and the Securities and Exchange Act of 1934 (Exchange Act). The 1933 statute regulated initial public offerings of securities. The 1934 statute regulated public offerings of securities following the initial offering, and it also created the Securities and Exchange Commission (SEC), the federal agency charged with enforcement of the 1933 and 1934 statutes. These two statutes are inapplicable to private corporations, i.e., those corporations whose securities are not traded on a public exchange.

Under Section 10(b) of the Exchange Act, in order to plead a case of securities fraud, a plaintiff is required to state that: defendant made a materially false or misleading statement; the statement was contained in a document filed pursuant to the Exchange Act or any rule or regulation thereunder; plaintiff relied on the false statement; and plaintiff thereby incurred a loss (Pareteum case, headnote 7).

In the present case, plaintiffs sued the auditor and several of Pareteum's officers and directors, alleging they committed securities fraud by: (a) making false statements in its financial statements for 2018 and the first half of 2019; (b) filing those financial statements with the SEC; (c) the financial statements were read by plaintiffs; (d) plaintiffs relied on the false statements in the financial statements by purchasing the stock; and (e) plaintiffs thereby incurred a financial loss. The auditor also allegedly made a false statement when it stated it had complied with PCAOB standards during the audit, and that the client's financial statements were prepared in accordance with Generally Accepted Accounting Principles (Pareteum case, pp. 36-44).

6. What is the Significance of Securities Act Section 11 to the Auditor's Liability in this Case?

Section 11(a)(4) of the Securities Act provides for liability against an Accountant or Auditor if any part of the Registration Statement contained an untrue statement of a material fact or omission of a material fact required to be stated therein. In this case, the auditor was sued pursuant to Section 11 because of the material misstatements in the financial statements which were filed in the Registration Statement of the secondary offering of stock (Pareteum case, headnote 34 and pp. 60-61).

7. In a Securities Act Section 11 Claim against an Auditor, Is Scienter of the Auditor required to be Proven?

No. Scienter refers to one's knowledge regarding the filing of the false information in the Registration Statement. To be liable under Section 11, it is not necessary that the Auditor knew that the information in the financial statements was false. Section 11 liability may be present even if the auditor had no knowledge that the financial statements had material misstatements, or even if the auditor truly believed, with justification, that the financial statements contained no material misstatements. Section 11 was designed to assure compliance with the disclosure provisions of the Securities Act by imposing a stringent standard of liability on the parties (such as an accountant or auditor) who play a direct role in a registration offering. To prove a *prima facie* case against an auditor, plaintiff only needs to show that the information filed in the Registration Statement contained a material misstatement or omission (Pareteum case, headnote 28).

8. Is the Mere Issuance of an Auditor's Unqualified Opinion Regarding the Client's Financial Statements Actionable?

Ordinarily, no. The auditor's opinion that a client has fairly stated its financial position and results of operations is not itself actionable; an opinion is not a statement of fact or a warranty of correctness. In order to make the auditor's opinion actionable, more must be shown: that the auditor does not honestly hold the belief expressed, or that the opinion contains an embedded statement of a materially false fact, or if the opinion omits a fact that makes the opinion misleading to an ordinary investor (Pareteum case, headnote 35).

9. What Is the Significance of SEC Rule 10b-5 In This Case?

SEC Rule 10b-5 broadly prohibits publicly-traded corporations' fraudulent and deceptive practices and untrue statements or omissions of material facts in connection with the purchase or sale of any security. Unlike Section 18 of the Exchange Act, this provision applies to any information released to the public by the issuing corporation, including press releases and annual and quarterly reports to stockholders.In this case, SEC Rule 10b-5 was allegedly violated when Pareteum filed inaccurate financial statements with the SEC (Pareteum case, pp. 36-37).

10. What is the Effect of the Private Securities Litigation Reform Act (PSLRA) on a Plaintiff's Pleading of a Securities Fraud Claim?

The PSLRA, a federal securities statute enacted in 1995, was designed to prevent unwarranted or frivolous lawsuits from being filed, which can be expensive, time-consuming and can reduce the efficiency of the legal system. The PSLRA requires a plaintiff to state with particularity the circumstances constituting defendant's fraud or mistake. Conclusory allegations are insufficient. Plaintiffs must comply with stringent pleading requirements, *to wit*: they must allege specific fraudulent statements made by defendant, that the statements were made recklessly or intentionally, and that they relied upon the false statements and thereby incurred a financial loss because of the fraud. Before the PSLRA was enacted, plaintiffs could reasonably file a lawsuit simply because the price of a security had changed significantly (Pareteum case, headnote 4; and Chen, 2020).

In this case, plaintiff complied with the stringent pleading requirements of the PSLRA because plaintiff stated with specificity how the three defendants committed securities fraud. (Pareteum case, pp. 35-36).

11. Why Are Pareteum's Internal Controls, Or Lack Thereof, Significant In This Case?

A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with the authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements. Because of their inherent limitations, internal controls may not prevent or detect material misstatements or fraud; there is no guarantee (Pareteum case, headnote 2).

It is illegal for any publicly-traded firm to knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or accounting required to be kept under Section 13(b)(2) of the Exchange Act. Accordingly, the defendants, as officers of the firm, had a legal duty to maintain an effective system of internal accounting controls (Winemaster case, headnote 32 and pp. 92-93).

In the present case, Pareteum's auditor issued an adverse opinion on the firm's internal controls and informed the company that there was a strong possibility that material misstatements due to error or fraud could occur, but the company's officers and directors did not take decisive action to correct the problem, and the auditor failed to insist that the internal controls be corrected; in fact, the auditor made a bad situation worse by issuing an unqualified opinion on the financial statements while simultaneously issuing an adverse opinion on internal controls (Pareteum case, pp. 15-23)

12. Did the CEO have Responsibilities with Respect to the Financial Statements and the Internal Control System?

Yes. As CEO, Turner was responsible for reviewing and approving Pareteum's consolidated financial statements and approving, signing and certifying Pareteum's periodic public reports, including SEC Forms 10-K and 10-Q. When signing each of the SEC reports, Turner certified that each report did not include any material misstatements or omissions and fairly presented, in all material respects, Pareteum's financial condition for the reporting period. Additionally, Turner was responsible for establishing and maintaining Pareteum's internal accounting controls (Pareteum case, p. 44).

13. Did the Plaintiffs Successfully State a Claim Against the CEO and CFO For Control Person Liability?

Yes. In securities fraud law, control person liability may be used to hold a defendant vicariously liable for the securities violations committed by another. Section 20(a) of the Exchange Act lists the elements of control person liability. To simplify the explanation, the U.S. Seventh Circuit has expressed a 2-prong test for determination of control person liability: (1) the control person must have actually exercised general control over the operations of the fraudulent firm; and (2) the control person must have had the power or ability—even if not exercised—to control the specific transaction or activity that is alleged to give rise to liability (Winemaster case, headnote 28).

In this case, the SEC seeks to hold the CEO (Turner) and the CFO (O'Donnell) liable for securities fraud because they exercised general control over the corporation. In addition, the CEO and the CFO had the power or ability—even if not exercised—to control the specific transaction or activity that is alleged to give rise to liability; the CEO and CFO's signatures were required to be affixed to all items filed with the SEC, including the Registration Statement with the audited financial statements attached. Allegations that other corporate employees and the auditor have engaged in fraud does not immunize the CEO or CFO from liability for their knowing deception; they are responsible for the other employees' fraudulent acts (Pareteum case, pp. 44-45; and Winemaster case, pp. 92-95).

14. Why Was the Auditor Sued in This Case?

The auditor issued an unqualified opinion on Pareteum's financial statements, certified they had been prepared in accordance with GAAP, and gave reasonable assurance that the financial statements contained no material misstatements due to error or fraud. Investors relied upon the auditor's opinion and purchased Pareteum stock. Later, Pareteum was forced to restate its financial statements because it discovered its revenue had been overstated by $33 million in the most recent 18 month period, i.e., all of 2018 and the first half of 2019. Pareteum's stockholders lost their investments when the stock price plummeted, and they sued the auditor (as well as the firm and its directors and officers) for securities fraud (Pareteum case, pp. 60-65).

15. Is it inconsistent for an auditor to issue an unqualified opinion on the financial statements while simultaneously issuing an adverse opinion on the client's internal controls over financial reporting?

Yes. Internal controls are essential tools for ensuring that a firm will have no material misstatements in its financial statements due to errors or fraud. Internal controls and the financial statements are two of the major elements of a sound accounting system. These two elements cannot be viewed in isolation from one another; there is a symbiotic relationship between them (Pareteum case, headnote 2). The auditor in the case admitted that the firm did not have a workable internal control system; it issued an adverse opinion with respect to the internal controls (Pareteum case, pp. 16-21). With no internal controls, the firm became exceedingly prone to suffering material misstatements in its financial statements due to both errors and fraud. Of course, in this case, the principal reason for the overstatement of revenue was fraud, not errors, because the top managers knew that the revenue was being overstated (Pareteum case, pp. 45-46).

16. Is the issuance of an unqualified opinion on financial statements, coupled with the simultaneous issuance of an adverse opinion on internal controls, potentially actionable if the client's stockholders incurred damages in reliance on those two opinions?

Yes. The firm's internal control evaluation and the auditor's internal control evaluation both concluded that the internal controls had major problems, yet the firm apparently took no decisive action to correct the internal controls. And apparently the auditor did not insist that the internal controls be rectified as soon as possible. In a situation like this, both the firm, its officers and directors, and the auditor face significant legal exposure (Pareteum case, pp. 15-23).

17. As stated in (6) above, Section 11 of the Securities Act Requires An Auditor of a Publicly-Traded Firm To Provide Accurate and Current Financial Information When It Knows Its Client Will Be Filing It With the SEC In a Registration Statement for a Secondary Offering of Stock. Does an Auditing Standard Also Deal With this Issue?

Yes. The Public Company Accounting Oversight Board (PCAOB) has issued *Auditing Standard 4101: Responsibilities Regarding Filings Under Federal Securities Statutes*. AS 4101.10-11 mandates the auditor to perform meticulous subsequent events procedures whenever a Registration Statement is filed pursuant to the Securities Act. If during the course of those procedures the auditor discovers

subsequent events that require disclosures or adjustments in the financial statements, he is required to go to the next step and follow the guidance in AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (PCAOB, AS 4101).

18. Is the Auditor in This Case Potentially Liable For its Failure To Comply With Auditing Standard 4101?

Yes. Unfortunately, in the present case, the auditor failed to follow AS 4101. Instead, he allowed the client to file the unqualified audit opinion that he had previously prepared without correcting the financial statements. If he had adhered to the meticulous subsequent events procedures mandated by AS 4101, he should have been able to discover the material misstatements in the financial statements which were created by the CEO's fraud (Pareteum case, pp. 60-65; and PCAOB, AS 4101).

19. What Was the Final Outcome in This Case?

All of the defendants' motions to dismiss were denied. This litigation will continue and is ongoing (Pareteum case, p. 65).

20. Does the Filing of this Case Prevent Pareteum From Filing For Bankruptcy?

No. After this lawsuit was filed, Pareteum's board of directors and top management considered a wide range of strategic alternatives and sale of strategic assets. In order to facilitate an efficient sale process and to position itself for long-term success, Pareteum filed for Chapter 11 Reorganization Bankruptcy protection on May 19, 2022. Interim CEO Bart Weijermars stated: "Despite our business challenges, our products and services that we provide to customers remain strong and relevant in this competitive industry. . .by taking today's decisive and positive step, we are confident that under new ownership, the business can be best positioned for growth and to reach necessary scale and its full potential" (Tennant, 2022).

21. Conclusions and Implications for Auditors

a. The elements of a securities fraud case pursuant to the Exchange Act are: a materially false statement of defendant contained in a document filed with the Securities and Exchange Commission (SEC); the false statement was relied upon by plaintiff; and this caused plaintiff's financial loss.

b. The Private Securities Litigation Reform Act requires a plaintiff to comply with stringent pleading requirements and he must allege: specific fraudulent statements made by defendant; the statements were made recklessly or intentionally; and plaintiff justifiably relied upon the statements, thereby incurring a financial loss.

c. Section 11(a)(4) of the Securities Act provides for liability against an Accountant or Auditor if any part of the Registration Statement contained an untrue statement of a material fact or omission of a material fact required to be stated therein.

d. Scienter refers to one's knowledge regarding the filing of the false information in the Registration Statement. To be liable under Section 11, it is not necessary that the Auditor knew that the information in the financial statements was false. Section 11 liability may be present even if the auditor had no knowledge that the financial statements had material misstatements, or even if the auditor truly believed, with justification, that the financial statements contained no material misstatements.

e. In order to make an auditor's unqualified opinion of financial statements actionable, plaintiff must prove: the auditor does not honestly hold the belief expressed, or that the opinion contains an embedded statement of a materially false fact, or if the opinion omits a fact that makes the opinion misleading to an ordinary investor.

f. SEC Rule 10b-5 applies to any information released to the public by a publicly-traded corporation, including press releases and annual and quarterly reports to stockholders. Under this Rule, an auditor may be liable if the audited financial statements included or referred to in those reports are untruthful, deceptive or misleading.

g. It is illegal for any publicly-traded firm to knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or accounting required to be kept under Section 13(b)(2) of the Exchange Act.

h. A corporate CEO is responsible for reviewing and approving the company's financial statements and approving, signing and certifying its periodic public reports, including SEC Forms 10-K and 10-Q. When signing each of these SEC reports, the CEO certifies that each report does not include any material misstatements or omissions and fairly presents, in all material respects, the company's financial condition for the reporting period. Additionally, the CEO is responsible for establishing and maintaining the company's internal accounting controls.

i. In U.S. securities fraud law, control person liability may be used to hold a defendant vicariously liable for the securities violations committed by another. There is a 2-prong test for determination of control person liability: (1) the control person must have actually exercised general control over the operations of the fraudulent firm; and (2) the control person must have had the power or ability—even if not exercised—to control the specific transaction or activity that is alleged to give rise to liability.

j. The auditor in this case issued an unqualified opinion on Pareteum's financial statements, certified they had been prepared in accordance with generally accepted accounting

principles (GAAP), and gave reasonable assurance that the financial statements contained no material misstatements due to error or fraud. Investors relied upon the auditor's opinion and purchased Pareteum stock. Later, Pareteum was forced to restate its financial statements because it discovered its revenue had been overstated by $33 million in the most recent 18 month period. Pareteum's stockholders lost their investments when the stock price plummeted, and they sued the auditor (as well as the firm and its directors and officers) for securities fraud.

k. Internal controls and the financial statements are two of the major elements of a sound accounting system. These two elements cannot be viewed in isolation from one another; there is a symbiotic relationship between them. The auditor in this case admitted that the firm did not have a workable internal control system; it issued an adverse opinion with respect to the internal controls. With no internal controls, the firm became exceedingly prone to suffering material misstatements in its financial statements due to both errors and fraud. The fraud that actually occurred should not have been unexpected.

l. The firm's internal control evaluation and the auditor's internal control evaluation both concluded that the internal controls had major problems, yet the firm apparently took no decisive action to correct the internal controls. And apparently the auditor did not insist that the internal controls be rectified as soon as possible. In a situation like this, both the firm, its officers and directors, and the auditor face legal exposure and it culminated in this lawsuit.

m. The Public Company Accounting Oversight Board (PCAOB) has issued *Auditing Standard 4101: Responsibilities Regarding Filings Under Federal Securities Statutes*. AS 4101.10-11 mandates the auditor to perform meticulous subsequent event procedures whenever a Registration Statement is filed pursuant to the Securities Act. If during the course of those procedures the auditor discovers there is reason to believe that disclosures or adjustments to the financial statements are necessary, he is required to go to the next step and follow the guidance in AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

n. In this case, the auditor failed to follow AS 4101. Instead, he allowed the client to file the unqualified audit opinion he had previously prepared without correcting the financial statements. If he had adhered to the meticulous subsequent event procedures mandated by AS 4101, he should have been able to discover the material misstatements in the financial statements which were created by the CEO's fraud.

o. All of the defendants' motions to dismiss were denied. This litigation continues and is ongoing.

p. The filing of this lawsuit did not prevent Pareteum from filing for bankruptcy. After this lawsuit was filed, Pareteum's board of directors and top management considered a wide range of strategic alternatives and sale of strategic assets. In order to facilitate an efficient sale process and to position itself for long-term success, Pareteum filed for Chapter 11 Reorganization Bankruptcy protection on May 19, 2022.

q. These are some of the implications for auditors emanating from this case: (1) pursuant to Section 11 of the Securities Act, an auditor may be liable for securities fraud if the financial statements filed in a stock Registration Statement contain an untrue statement of a material fact or omission of a material fact required to be stated therein; (2) in a Section 11 claim against an auditor, plaintiff is not required to prove that the auditor knew the information in the financial statements was false; (3) the mere issuance of an auditor's unqualified opinion of the client's financial statements is not actionable, because an opinion is not a statement of fact or a warranty of correctness; (4) pursuant to Section 18 of the Exchange Act and SEC Rule 10b-5, all information released to the public by a corporation (including press releases and annual and quarterly reports to stockholders) containing information compiled by an auditor must be truthful and complete, and not deceptive or misleading; (5) an auditor should presume the client's revenue is overstated and apply stringent requirements regarding the firm's recognition of revenue; (6) it is inconsistent for an auditor to issue an unqualified opinion on a client's financial statements while simultaneously issuing an adverse opinion on the client's internal controls; (7) an auditor's simultaneous issuance of an unqualified opinion on financial statements and an adverse opinion on internal controls may be actionable if the client's stockholders incurred damages in reliance on those two opinions; (8) pursuant to Auditing Standard (AS) 4101, an auditor must implement meticulous subsequent event procedures whenever recent events occurring after the date of the financial statements have potentially made the financial statements incorrect, deceptive or misleading; and (9) the auditor in this case is potentially liable for its failure to comply with AS 4101 because, had he undertaken the required subsequent event procedures, he should have been able to discover the material misstatements in the financial statements which were created by the CEO's fraud.

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