Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended June 30, 2018

Q2 REPORT 2018

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Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the quarter ended June 30, 2018.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding financial reporting matters that will assist our clients in today's fast-paced and demanding market. This report is just one example of how we intend to fulfill this commitment.

The Division of Enforcement at the U.S. Securities and Exchange Commission ("SEC") is a law enforcement agency established to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As such, the actions they take and releases they issue provide very useful interpretations and applications of the securities laws.

For those involved in financial reporting, SEC releases concerning civil litigation and administrative actions that are identified as related to "accounting and auditing" are of particular importance. Our objective is to summarize and report on the major items disclosed in the AAERs, while also providing useful insights that the readers of our report will find valuable.

We welcome your comments and feedback, especially requests for any additional analysis you would find helpful.

Floyd Advisory
JULY 2018

Highlights:

- **Recent public statements have indicated the SEC is less focused on enforcement statistics as a measure of the agency's success and more focused on selective enforcement actions that emphasize better functioning markets and investor protection. In fact, there were only eleven SEC Enforcement Actions designated as AAERs in Q2 2018. This number represents the lowest quarterly amount in the publicly available eighteen years of published AAERs. The previous lowest quarterly amount was fourteen, occurring in both Q2 2012 and Q2 2014.**

- **The SEC found that a large public accounting firm engaged in improper professional conduct related to inadequate audit procedures and a deficient engagement review process. Relevant parties in this case include an audit partner and manager who each settled charges from the SEC on a no admit no deny basis and received Rule 102(e) suspensions during Q2 2017. The SEC subsequently required the firm to review and evaluate its quality controls, policies, and procedures for audits of SEC registrants and private funds, and to present its findings to the Commission.**

- **Finally, we report on the Altaba Inc. (formerly known as Yahoo! Inc.) case in our Recommended Reading section. This case involves allegations of Yahoo's failure to communicate multiple data security breach incidents to the public until over two years after the events occurred. These allegations of material misstatements and omissions relate to incidents that affected over 500 million user accounts, and raise questions about the company's failure to comply with disclosure requirements for material data breaches.**

Our Process and Methodology

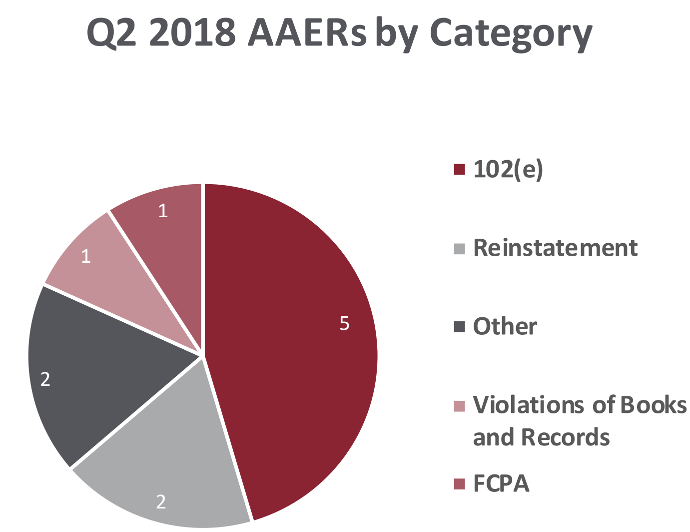
The SEC identifies and discloses accounting- and auditing-related enforcement actions from within its population of civil lawsuits brought in federal court, and its notices and orders concerning the institution and/or settlement of administrative proceedings as Accounting and Auditing Enforcement Releases ("AAERs"). The disclosed AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all of the actions that may fit into the definition above.

To meet our objective of summarizing the major items reported in the AAERs, we reviewed those releases identified and disclosed by the SEC on its website, www.sec.gov.

As part of our review, we gathered information and key facts, identified common attributes, noted trends, and observed material events. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (i.e., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC, Violations of Books and Records, and Other). Do note, when a release included more than one allegation, admission, or violation, we placed the release into the category which represented the most significant issue. Based on this process and methodology, we prepared a database of the key facts in each release.

The Q2 2018 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed eleven AAERs during Q2 2018, with SEC Rule 102(e) actions representing 45% of the total releases.



While our categorical breakdown is analytically useful, a closer look at specific cases for each category provides a clearer understanding of the SEC's areas of focus as an enforcement agency.

Rule 102(e) Actions

Rule 102(e) actions involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC. For accountants, the standards under which one may be penalized with a Rule 102(e) action include reckless, as well as negligent conduct, defined as a single instance of highly unreasonable conduct that violates professional standards or repeated instances of unreasonable conduct resulting in a violation of professional standards and indicating a lack of competence.

Six individuals and three firms received Rule 102(e) sanctions. Four of these individuals and all three firms neither admitted nor denied the charges, while the remaining two individuals admitted to the charges against them.

Examples of the actions reported in this quarter's Rule 102(e) releases include the following:

- ***The SEC suspended two former employees of a technology firm related to allegations of financial reporting fraud.*** According to the SEC, a Finance Director and a Financial Management Controller overstated their company's income by concealing uncollectible receivables that should have been written off, reversing

> "Today, the SEC, no longer measuring its success by tallying up enforcement statistics, is making a more concerted effort to bring only meaningful enforcement actions. Under the careful leadership of Chairman Jay Clayton, and our Enforcement Co-Directors Stephanie Avakian and Steven Peikin, the Commission is focusing its resources on key areas of concern...."
>
> Commissioner Hester M. Peirce
> Denver, CO
> May 11, 2018
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> The Why Behind the No: Remarks at the 50th Annual Rocky Mountain Securities Conference

previously recorded expenses and foreign exchange losses, and prematurely recognizing a vendor rebate. The claim states that the employees, to conceal their fraud, tracked their activity in a reconciliation spreadsheet that was maintained by a subordinate and falsified the reconciliation by altering the amounts in the spreadsheet to match the liability balance in the company's accounting system. The SEC fined both former employees for disgorgement and prejudgment interest. These fines were deemed satisfied by payments to the U.K. Financial Reporting Council.

- ***The SEC sanctioned a public accounting firm and its president who is also a partner and 50% owner for engaging in improper professional conduct.*** The SEC alleged that the firm and the audit partner failed to comply with PCAOB standards during a client's audits and interim reviews. Per the SEC, the client's CEO, who is also the CFO, made multiple unauthorized withdrawals of corporate funds which were not disclosed in the 2013 public filings. Allegedly, the audit partner recommended that the CEO either recognize the overpayments as compensation or execute a promissory note with the company for the amount by which the withdrawals exceeded the CEO's salary. According to the Commission, the audit partner helped the company's CEO conceal the unauthorized withdrawals and assisted in conceiving the promissory note. Additionally, the audit partner failed to satisfy applicable review and audit standards. The SEC fined both respondents for disgorgement, prejudgment interest, and a joint civil monetary penalty.

- ***The SEC sanctioned a public accounting firm and two of its employees for engaging in improper professional conduct throughout an audit.*** According to the SEC, the firm and its employees failed to meet requirements of the Custody Rule to conduct an audit of an investment adviser's fund. The SEC also alleged that the audit firm was not independent, as it had prepared financial statements and notes to the financials for the fund in 2014 and 2015, and also had a direct business relationship with the fund's investment manager. The audit firm allegedly was not subject to regular PCAOB inspection at the time of the 2014 and 2015 engagement periods. Additionally, the audit allegedly failed to adhere to certain professional auditing standards and certain of the SEC's professional quality control standards. The SEC fined the firm and one of its employees for disgorgement, prejudgment interest, and civil monetary penalties.

- ***The SEC suspended a CEO for making material misstatements and/or misleading omissions on his company's quarterly reports.*** According to the Commission's original complaint, the CEO, who is also a CPA, overstated assets on the balance sheet related to an acquired company. The complaint further alleges that the company and the CEO wrote down the value of the assets related to the acquired company but failed to disclose that the company never paid the full purchase price initially disclosed and that the assets were not worth the amount initially recorded, resulting in a material overstatement of the balance sheets in the first two quarters of 2013. The SEC suspended the CPA from appearing or practicing before the Commission as an accountant.

- ***The Commission accepted Offers of Settlement from a national public accounting firm for alleged improper professional conduct while performing a 2011 audit.*** The accounting firm was hired to perform the audit of a private fund formed for the general purpose of acquiring oil and gas royalty interests to generate a return for its investors. An engagement partner and engagement manager were not on the audit firm's preapproved list for Financial Services Practices audits but were approved by the Regional Professional Practices Officer with the understanding that a concurring

"Auditors play a vital role in the capital markets, in part, because of their impartial and objective judgment about companies' financial reporting. The integrity and credibility of their judgment is critical, and is reinforced by auditors' independence from company management. Just as auditors need continually to monitor and assess their maintenance of this independence from their audit clients, we, as regulators, need to monitor and assess our auditor independence rules."

Wesley Bricker
Chief Accountant
New York, NY
May 3, 2018

Remarks before the 2018 Baruch College Financial Reporting Conference: "Working Together to Advance Financial Reporting"

review partner would also be on the audit. According to the SEC, the manager falsified schedules of investments workpapers and manually inserted initials of staff members to conceal audit work that was not completed. Per the SEC, the financial statements were not prepared in conformity with GAAP and the engagement partner neglected to review many of the investment workpapers and therefore could not determine if the audit procedures performed were adequate or complete. The SEC ordered the firm to perform a review and evaluation of the sufficiency and adequacy of its quality controls and policies and procedures for all audits of SEC registrants as well as audits of private funds within its Financial Services Practice, and to present its findings to the Commission.

FCPA Violations

There was one FCPA-related release in Q2 2018 resulting in $9.2 million in civil penalties, disgorgement, and prejudgment interest.

- ***The Commission accepted an offer of settlement from a company that provides commercial data to businesses and other entities.*** Two of the company's subsidiaries allegedly made unlawful payments to obtain and retain business from 2006 through 2012. According to the SEC, the company did not reflect the unlawful payments in the subsidiaries' books and records, which ultimately consolidated into the company's books and records. The company is also charged with failing to maintain adequate internal accounting controls to detect or prevent the improper payments. The claim states the company engaged in a joint venture partnership with a subsidiary that acquired non-public business data through unofficial arrangements and made improper payments to government officials. The company also acquired a direct marketing services company in China that allegedly violated Chinese laws with respect to consumer data that had been obtained post-acquisition.

Reinstatements

- ***In separate releases, the SEC reinstated two CPAs to appear and practice before the Commission as accountants.*** The first reinstatement relates to a CPA that was previously suspended from practicing due to an alleged failure to recognize a subsidiary's loan losses and a failure to adequately disclose the nature of the loans. The second reinstatement, according to the Commission's original complaint, relates to a CPA that engaged in a fraudulent scheme which resulted in the filing of materially false and misleading financial statements in the company's Form 10-K for 2000 and third quarter Form 10-Q for the year 2000. The complaint alleged that the CPA increased the company's annual and quarterly revenue and net income through practices such as improperly accelerating the recognition of revenue from the sale of a construction contract and concealing undocumented side agreements from the company's auditors. In both cases, the CPAs have complied with the terms of the suspensions and are therefore reinstated to appear and practice before the Commission as accountants responsible for the preparation or review of financial statements filed with the Commission.

Violations of Books and Records

This quarter we categorized one AAER under Violations of Books and Records, a category that includes alleged improper accounting treatments and internal control problems deemed worthy of an enforcement action but not meriting financial reporting fraud allegations.

- ***The subsidiary of a multinational company prematurely recognized revenue in violation of GAAP, failed to accurately record payments to sales agents and failed to maintain sufficient internal accounting controls.*** The company retained a sales representative to assist in contract negotiations for the sale of products to clients in the Middle East. According to the SEC, despite a lack of qualifications to negotiate technical contracts and allegations from regional employees of paying bribes to win business, the company continued to use the sales representative. During the negotiation of amendments to a contract with a government airline, an executive from the airline allegedly solicited the sales representative for personal benefits, including a position with the company. In or around 2007, the company offered the airline executive a position with the company and arranged for additional payments to the executive through an unrelated third-party vendor. The SEC alleged that this airline executive was one of several consultants who were engaged and paid in instances where limited or no legitimate services were provided. The SEC also alleged that the company overstated its net income for the quarter ending June 30, 2012 by $22.4 million or 16%, by backdating an agreement with the government airline and providing misleading information to its auditor. Due to the foregoing, the SEC claimed that the company failed to accurately record transactions in its books and records and failed to devise and maintain adequate internal accounting controls with respect to the retention of sales agents. The Commission also alleged that the company failed to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP.

Other

- ***The SEC sanctioned a company and its founder (and sole officer and director) that continued to use an audit firm that had its PCAOB registration revoked.*** Per the SEC, the Commission's Division of Corporation Finance sent an email to the company regarding the deregistration of its audit firm from the PCAOB. In this email, the Commission notified the company that it was barred from associating with the public accounting firm going forward, and that it was unlawful to permit the audit firm to remain associated with the company in an accountancy or financial management capacity. Despite this notification, the audit firm continued to provide professional services to the company for a period of several months following the initial communication from the Division of Corporation Finance.

Notable Q2 2018 AAER for "Recommended Reading"

While reviewing all of the SEC's AAERs would prove insightful, certain releases present information that is especially worthy of further review and analysis by those involved with financial reporting matters. We deem these particular releases as earning the distinction of Recommended Reading for our clients.

"The audit profession continues to evolve and audit quality has improved over time. Audit committees and their key partner, the PCAOB, rightfully expect this evolution. Yet, to meet the realities of growth, multidisciplinary scope, and a need for greater consistency of quality audit work in all parts of the world, the audit profession must continue to focus, and in some respects do more, to maintain and nurture trust."

Wesley Bricker
Chief Accountant
New York, N.Y.
May 3, 2018

Remarks before the 2018 Baruch College Financial Reporting Conference: "Working Together to Advance Financial Reporting"

For this quarter, we selected the following AAER to highlight. This case involves charges against Altaba Inc., formerly known as Yahoo! Inc. ("Yahoo"), for material misstatements and omissions regarding a massive data breach. According to the AAER, the company did not maintain disclosure controls and procedures to ensure that reports from Yahoo's information security team were properly and timely assessed to determine if the breach should be disclosed.

Accounting and Auditing Enforcement Release No. 3937 / April 24, 2018, Administrative Proceeding File No. 3-18448, In the Matter of Altaba Inc., f/d/b/a Yahoo! Inc., Respondent.

Proper reporting for public registrants involves much more than producing financial statements in accordance with generally accepted accounting principles. In fact, the disclosures made in public filings may be as or more important, and meaningful to financial statement users than what is reported on the financial statements alone.

In Item 303(a) of Regulation S-K, the United States Securities and Exchange Commission requires that a public registrant discuss its financial condition, changes in financial condition and results of operations in the company's management discussion and analysis section of its public filings. The requirements include identifying "any known trends or any known demands, commitments, events, or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way." Another major requirement is to report "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

Complying with Item 303(a) means companies must open the door to senior management discussions and share a significant amount of information with investors. Not surprisingly, for many management teams, sharing positive news is easy, whereas openly sharing information regarding problems is not.

A recent SEC Accounting and Auditing Enforcement Release regarding the settlement of an action against Altaba Inc. (the "Company") provides a very useful example of the failure to comply with disclosure requirements for an unfavorable event that involved the material data breach involving personal customer information. The Company is more well known by its former name, Yahoo! Inc.

Of great concern, the SEC indicates that many people in the Company, including senior executives, had complete transparency regarding the extent of the data breach and its risks to the Company, yet the information was withheld from the shareholders for almost two years.

Below is a summary of the key facts in the case, including what the Company knew compared to what they contemporaneously disclosed, as well as observations for audit committees and those that advise public registrants to avoid similar lapses in judgment.

Background

Per the AAER, in late 2014, the Company learned of a "massive breach of its user database that resulted in the theft, unauthorized access, and acquisition of hundreds of millions of its users' data, including usernames, birthdates, and telephone numbers" by hackers associated with the Russian Federation. Almost immediately, the Company's senior management and legal teams received various internal reports from the Company's Chief Information Security Officer describing the severity of the problem. Of note, the SEC conveys that the Company's senior management and legal teams did not report this situation to the Company's auditors or outside counsel.

Rather than resolving the data breach, the situation worsened in 2015 and 2016 as the Company's information security team determined that the same hackers were continuously targeting the user database. The information security team also received reports raising the possibility of a high volume of compromised user credentials for sale on the dark web. In fact, according to the SEC, in June 2016, the Company's new Chief Information Security Officer (hired in October 2015) concluded that Yahoo's entire user database, including the personal data of its users, had likely been stolen by "nation-state actors" through several hacker intrusions (including the 2014 breach), and ultimately could be exposed on the dark web in the immediate future.

The release states that the new Chief Information Security Officer communicated these conclusions to at least one member of the Company's senior management while the Company was negotiating the sale of its operating business to a major telecommunications business. Yet the Company still made no public disclosure of the problem and to the contrary, affirmatively represented that it was unaware of any security breaches in its stock purchase agreement with the telecommunications business, a document subsequently filed as an exhibit to a Form 8-K on July 25, 2016, and therefore a public record.

The SEC alleged that the Company failed to disclose the data breach in any public filings until the third quarter of 2016, making its 2014 and 2015 Form 10-Ks and Form 10-Qs for the first three quarters of 2015 and the first two quarters of 2016 deficient and misleading.

Remarkably, the Company's disclosures in its annual and quarterly reports from 2014 through 2016 reported that it had only faced the "risk of potential future data breaches" that might expose the Company to adverse consequences and didn't disclose such a breach had in fact already occurred. The disclosures in the public filings during the time periods included the following statements:

> "[p]roducts and services involve the storage and transmission of Yahoo's users' and customers' personal and proprietary information in our facilities and on our equipment, networks, and corporate systems."
>
> "If our security measures are breached, our products and services may be perceived as not being secure, users and customers may curtail or stop using our products and services, and we may incur significant legal and financial exposure."
>
> "[s]ecurity breaches expose us to a risk of loss of this information, litigation, remediation costs, increased costs for security measures, loss of revenue, damage to our reputation, and potential liability."

Yet, the breach had occurred and describing the risks with an "if" qualifier didn't match reality, as the consequences were not theoretical, they were imminent.

Market evidence for the materiality of the breach occurred in September 2016, when the Company disclosed the 2014 data breach and its market capitalization dropped

"Hacking and data intrusion undermine investor confidence in the fair and orderly operation of our markets, and the corresponding temptation to skirt disclosure of such events only compounds the problem. So cyber-related matters reflect an unquestionably urgent group of challenges, warranting the allocation of significant agency resources. And so far, the work of the dedicated professionals on the staff to move so quickly into this space is paying dividends."

Steven Peikin
Co-Director, Division of Enforcement
New York, NY
May 15, 2018

Keynote Address to the UJA Federation

approximately $1.3 billion due to a 3% decrease in its stock price. Further evidence of the materiality of the breach is found in the renegotiation of its stock purchase agreement described above and the reduction to the price for the Company's operating business of $350 million, representing a 7.25% reduction.

Not surprisingly, when the Company finally disclosed the problem in its Form 10-Q for the third quarter of 2016, it stated that the Company expected to incur expenses—including investigation, remediation, and legal costs—related to the 2014 breach. Also, not surprising, in its 2016 Form 10-K, the Company disclosed that its principal executive officer and principal financial officer had concluded that, "due exclusively to deficiencies in the Company's existing security incident response protocols related to the 2014 Security Incident, the Company's disclosure controls and procedures for each of the annual and quarterly periods ended December 31, 2014 through September 30, 2016 were not effective at the end of each such period."

The settlement with the SEC included a cease and desist order, a $35 million civil penalty and a cooperation agreement with the Company related to any and all other proceedings arising out of the situation. Needless to say, the cooperation agreement indicates that the SEC may be bringing other actions soon. Based on a review of the facts discussed above in the SEC's AAER, it's understandable why further actions may be forthcoming.

Major Observations and Recommendations

Having reviewed the Company's failures to comply with proper disclosures and to have controls in place for all information, good and bad, to be vetted, raises the obvious question of what can be done to avoid similar situations.

Needless to say, situations where senior management suppresses information may make traditional disclosure committees and processes useless. However, old fashioned employee training and whistleblower hotlines can be an audit committee's strongest ally to ensure facts are vetted properly, assessed, and disclosed. The AAER makes no mention of whether the Company had such training or hotlines.

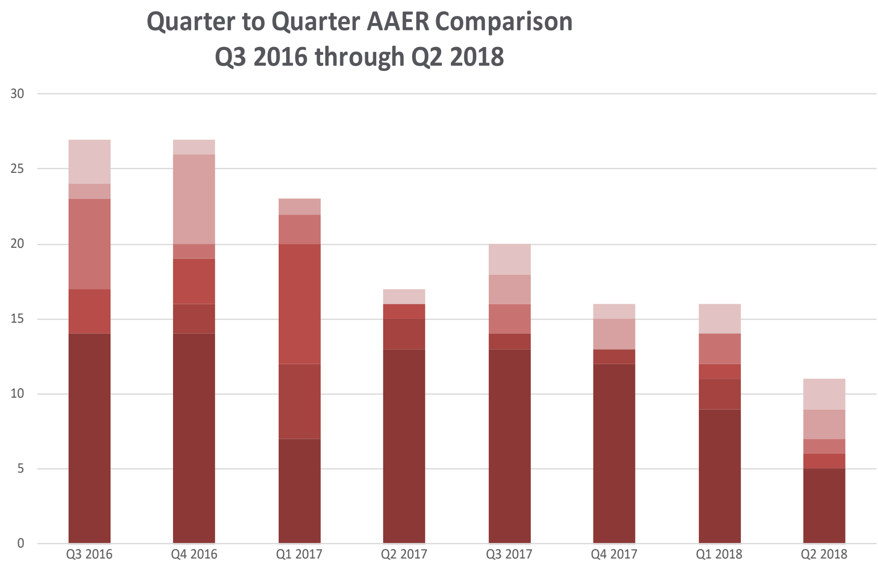
In addition, noting the risk disclosure in place for the Company, targeted questions by the audit committee for updates may have brought the problem to a board level discussion. Such questions of management should include but not be limited to previously disclosed risk factors and should encompass industry-wide risks and concerns. For the Company, the entire industry has been under pressure for data breaches and hacking.

Finally, and possibly among the most notable, as well as troubling observation from the AAER is the lack of any discussion with outside counsel regarding the data breach. Certainly, cost containment is a major reason that many companies manage situations internally for as long as possible before engaging outside counsel and experts. However, from a control and governance standpoint, all matters involving the general counsel's office should have a client code, and such a listing should be available to the company's auditors so that all company risks are at a minimum transparent for audit purposes and subject to consideration when meeting the SEC requirements for disclosures under Item 303(a) of Regulation S-K.

Prior Period Comparison: Quarter to Quarter

As described in the section titled "Our Process and Methodology," AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all the actions that may fit into the definition the SEC provides for the classification. That said, comparisons of the number of AAERs between periods may be a useful gauge of the SEC's activities.

The following chart maps quarterly totals for each category over the past 8 quarters.



	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018
Other	3	1	0	1	2	1	2	2
Reinstatement	1	6	1	0	2	2	0	2
FCPA	6	1	2	0	2	0	2	1
Violations of Books and Records	3	3	8	1	0	0	1	1
Financial Reporting Fraud	0	2	5	2	1	1	2	0
102(e)	14	14	7	13	13	12	9	5

Based on this data, we made the following observations:

- Rule 102(e) sanctions continue to be the most common category of AAERs by far, constituting 45% of the total releases during Q2 2018.
- The downward trend in AAERs per quarter continues in recent periods. The quarterly average for the twelve months ending Q2 2018 was 16 AAERs, as opposed to a quarterly average of 24 AAERs for the twelve months ending Q2 2017.
- After a minimum of seven, and as many as fourteen, AAERs with Rule 102(e) sanctions in each quarter from Q3 2016 to Q1 2018, there were only five such releases in Q2 2018. As mentioned, the Rule 102(e) category has been the most common category in recent periods, thus the Rule 102(e) reduction in Q2 2018 significantly contributes to the overall downward trend in AAERs per quarter.

"To appropriately calibrate our enforcement program, we must spend our limited enforcement resources wisely. We cannot bring an enforcement action every time we discover a violation, nor should we. The current hiring freeze makes the need for careful use of resources even more pressing than it normally is. We cannot bring every case under the sun, but must focus on the cases that will actually make a difference. This careful approach to enforcement is what we owe taxpayers, investors, and all of the participants in our capital markets."

Commissioner Hester M. Peirce
Denver, CO
May 11, 2018

The Why Behind the No: Remarks at the 50th Annual Rocky Mountain Securities Conference

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ABOUT Floyd Advisory

Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of Business Strategy, Valuation, SEC Reporting, Transaction Analysis and Litigation Services.

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