FLOYD ADVISORY LLC

Summary of Accounting and Auditing Enforcement Releases for the Three Months Ended March 31, 2011

Floyd Advisory LLC is pleased to present you with our Summary of the U. S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAER's") for the three months ended March 31, 2011 ("Q1 2011").

As an independent boutique forensic accounting and business advisory firm, 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 regarding civil litigation and administrative actions that are identified as "accounting and auditing" related are of special importance. Our objective is to summarize and report on the major items disclosed in the AAER's, while also providing useful insights that the readers of our report will find valuable.

We welcome your comments and feedback, especially as to what additional analysis you would find helpful.

Floyd Advisory LLC
April 2011

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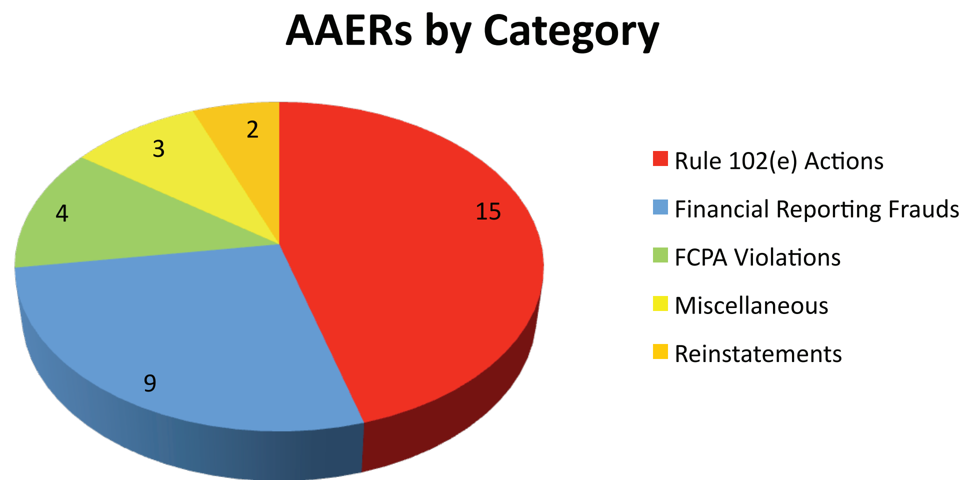
The Q1 2011 AAER's; Summary by Category and Insights from the Releases

The SEC disclosed thirty three AAER's during Q1 2011 which we have organized into the following categories as shown in the chart. While useful analytically to see the categorical breakdown for the releases, a closer look into each group provides insights on the SEC's actions.



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 ("AAER"). Importantly, the disclosed AAER's 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 AAER's, while also providing useful insights that the readers of our report find valuable, we reviewed the AAER's 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, and based solely on the publicly disclosed information, we also sorted the releases into major categories, (notably; Rule 102 (e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC and Miscellaneous) and classifications for the financial reporting issues involved (notably: Improper Revenue Recognition, Manipulation of Reserves, Intentional Misstatement of Expenses, Balance sheet Manipulation, Options Backdating and Defalcations). 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. For our summary of financial reporting issues, we recorded each accounting problem identified as a separate item. Based on this process and methodology, we prepared a database for the key facts in each release.

Speech by SEC Commissioner: Setting Forth Aspirations for 2011

"I envision a world where when the SEC announces a settlement in a high profile case, its impact is clearly noted — and leaves little doubt that it will make people that are engaged in similar activities think twice. An enforcement action by the SEC should be serious business, and it should cause an organization to seriously review how it has been operating. Moreover, our enforcement actions should have market-wide impact, and there should be sanctions that are significant enough to stop similar conduct in its tracks. The possibility of being sanctioned by the Commission should not be considered part of the cost of doing business."

by Commissioner Luis A. Aguilar
U.S. Securities and Exchange Commission
Address to Practising Law Institute's SEC Speaks in 2011 Program

Financial Reporting Frauds

There were nine AAER'S that we categorized as financial reporting frauds during the quarter. The types of fraudulent behavior described in a few of the more significant releases include:

- A defalcation for over $30 million by an employee serving as the Principle Accounting Officer, Secretary and Vice President of Finance, at Koss Corporation in Milwaukee, Wisconsin. The fraud is remarkable for several reasons; the length of time during which she was able to conceal her acts from the auditors, the size of her theft at a company with less than $50 million in net sales ($5,099,900 and $8,498,434 for the fiscal years ended June 30, 2008 and 2009, and $10,286,988 from July 1, 2009 until the unauthorized transactions were discovered in December 2009), the lack of segregation of duties allowing her to dominate the controls of a public company and the fact that Koss Corporation as a smaller public registrant, did not have to comply with the Sarbanes-Oxley Section 404 rules for the documentation and testing of internal controls until 2010, something that very well may have detected her fraud earlier or certainly deterred her actions. The accounting officer pled guilty in a related criminal matter in the U.S. District court for the Eastern District of Wisconsin on November 17, 2010.

- Fabricated revenue at an Arizona based health food company NutraCea involving the CEO, the former CFO, former Senior Vice President and Secretary, the former Controller, and the former Director of Financial Services. The fraud occurred in 2007 and involved the CEO instructing a customer to falsify their net worth statement to provide docu-

mentation supporting their ability to pay for the product and the former COO providing $1 million to the customer so that the customer could make the initial payment for the product. Without these actions by the NutraCea officers, the sale to the customer would have received consignment treatment for collectability reasons and not met the revenue recognition criteria. NutraCea also improperly recognized revenue on a large bill and hold transaction. Per the release, these two transactions overstated NutraCea's product sales revenue in fiscal year 2007 by 36.8%.

- The SEC filed an enforcement action under Section 304 of the Sarbanes-Oxley Act of 2002 against the CEO and President of Beazer Homes USA, Inc. ("Beazer") seeking to recover bonuses and other compensation as well as stock sale profits received while the company was committing accounting fraud. Beazer's alleged fraudulent conduct occurred in 2006, related to the manipulation of land development and house cost to complete accounts to increase income and the improper recording of certain model home financing transactions as sales, also to increase income. Of note, the CEO was not individually charged with the underlying misconduct or alleged to have violated the securities laws. Even so, the CEO has agreed to reimburse Beazer almost $6.5 million representing his 2006 cash and stock compensation. The settlement is subject to court approval.

- Two former officers at Equipment Finance, LLC formerly a subsidiary of Sterling Financial Corp., ("Sterling") a publicly traded bank holding company, were charged with conducting a fraud that lasted over five years from 2002 through 2006. The scheme involved creating fictitious loans for the purpose of making monthly payments on delinquent loans, largely for the purpose of hiding losses and defaults within the entity's commercial loan portfolio from Sterling management and the auditors. The officers prepared false accounting entries, false collateral descriptions and appraisals, fabricated UCC filings and recruited vendors to assist in the circumvention of loan confirmations by the auditors. In total Sterling wrote off $281 million of the entity's receivables after the fraud was discovered. The officers pled guilty to criminal charges and have agreed to a bar from serving as an officer or director of a public company and will pay disgorgement and interest penalties.

Rule 102 (e) Actions

Rule 102 (e) actions involve the censure and denial, temporarily or permanently, 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, which is 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.

Notably, of the individuals receiving Rule 102 (e) sanctions during Q1 2011, twelve were certified public accountants. Three of these individuals were penalized for actions while serving as partners in public accounting firms and nine were penalized for roles related to either financial reporting problems at corporations or for involvement in fraudulent schemes.

Significant among the Q1 2011 releases is the Order Instituting Public Administrative and Cease and Desist Proceedings Pursuant to Sections 4C and 21C of the Securities and Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease and Desist Order against KPMG Australia, as a firm, for violating auditor independence rules. See the "Recommended Reading" section of this report for a discussion regarding this release.

As a final observation from reviewing the Rule 102 (e) releases, The IndyMac Bancorp, Inc. and Countrywide Financial Corporation CFOs' appeared among this quarter's population. Prospectively, one would expect to see more AAER activity from the financial crisis.

FCPA Violations

There were four FCPA related releases in Q1 2011, including the well-publicized action with IBM for improper cash payments, gifts and travel and entertainment to government officials in South Korea and China. IBM agreed to pay $10 million to settle the SEC action including disgorgement of $5.3 million, interest of $2.7 million and a $2 million civil penalty. Most troubling, the alleged activities appear to have started in 1998 and continued through 2009. Remarkably, this is not the first FCPA problem for IBM. In 2000, the company paid a $300,000 penalty in connection with improper payments to foreign officials for a $250 million contract to integrate and modernize a computer system of a commercial bank owned by the Argentine government. The reported improper payments of at least $4.5 million were to several of the bank's directors.

Similar to IBM, Maxwell Technologies settled an FCPA matter involving bribes to government officials in China in Q1 2011 for a fine of approximately $6.3 million.

Reinstatements

During Q1 2011, one certified public accountant and one attorney were reinstated to appear and practice before the SEC. The accountant's suspension arose from the failure to properly perform audit procedures including adequately informing an audit committee of suspected illegal acts that were detected in the course of the audit.

The reinstated attorney's suspension arose from alleged actions while serving as an in-house counsel at Enron. Notably, the Enron attorney consented to the Rule 102 (e) suspension in April 2006 without admitting or denying to the allegations. Importantly, he did pay $1 million in disgorgement and a $30,000 civil penalty ordered by the United States District Court for the Southern District of Texas related to an SEC enforcement action.

While all of the original allegations against the Enron attorney are problematic, the alleged conduct described below from an excerpt from the original Rule 102(e) order for concealing information from the auditors is most concerning:

> The Commission's complaint alleged, among other things, that [the Enron attorney] engaged in a fraudulent scheme to improperly accelerate the recognition of revenue from the sale of a construction contract which resulted in Enron filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2000, and in the company's quarterly report on Form 10-Q for the third quarter of fiscal year 2000. The Complaint alleged that [the Enron attorney], the primary Enron in-house attorney working on the sale, negotiated various terms of the transaction and drafted several of the key documents. While doing this, he worked closely with Enron's accountants to ensure that the wording in the legal documents did not jeopardize ENA's efforts to circumvent Generally Accepted Accounting Principles. In addition, the complaint alleged that [the Enron attorney] knew that undocumented side agreements relating to the sale were being concealed from Enron's independent auditors and that he actively sought to keep others from disclosing information to the auditors about these side agreements.

Section 303(a) of the Sarbanes-Oxley Act of 2002, passed after the Enron attorney's alleged conduct addresses improper dealings with auditors, making such conduct illegal and states:

> It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary or appropriate in the public interest and for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

Miscellaneous

The three releases included in the miscellaneous category all involve similar items; cease and desist orders, internal control problems and flawed accounting treatments. Two involve penalties while the third for ArthroCare Corporation ("ArthroCare"), which appears to be the most serious in terms of financial reporting problems, does not. Of significance, the ArthroCare release describes the substantial "cooperation and remediation" efforts by the company as part of the decision making process in accepting ArthroCare's offer of settlement.

The release details the remediation efforts, in addition to replacing the senior management team, as follows:

(i) Expanded its legal department and created a compliance department led by a newly hired Compliance Officer,
(ii) Hired a new Corporate Controller and International Controller,
(iii) Expanded its internal audit function,
(iv) Instituted enhanced preventative and detective controls relating to revenue recognition,
(v) Instituted quarterly ethics communications from senior management to employees,
(vi) Implemented a sub-certification process as part of its quarterly and annual financial reporting,
(vii) Adopted standard customer contracts and established rigorous approval requirements for modifying contracts,
(viii) Hired a contract administrator, and
(ix) Provided regular training on proper revenue recognition accounting and appropriate procedures for handling contracts.

The release also describes cooperation received during the investigation as follows:

(i) Regularly updated the staff on its internal investigation,
(ii) Provided critical documents (organized by subject matter and witness) without waiting for staff requests or subpoenas,
(iii) Responded promptly and completely to the staff's requests for additional information,
(iv) Routinely granted the staff access to the company's consulting expert to discuss accounting and internal controls issues,
(v) Voluntarily produced for testimony witnesses who resided outside the United States and were beyond the staff's subpoena power, and
(vi) Provided the staff with a detailed analysis of its restatement, including a schedule of restatement categories and the impact on the company's historical financial statements.

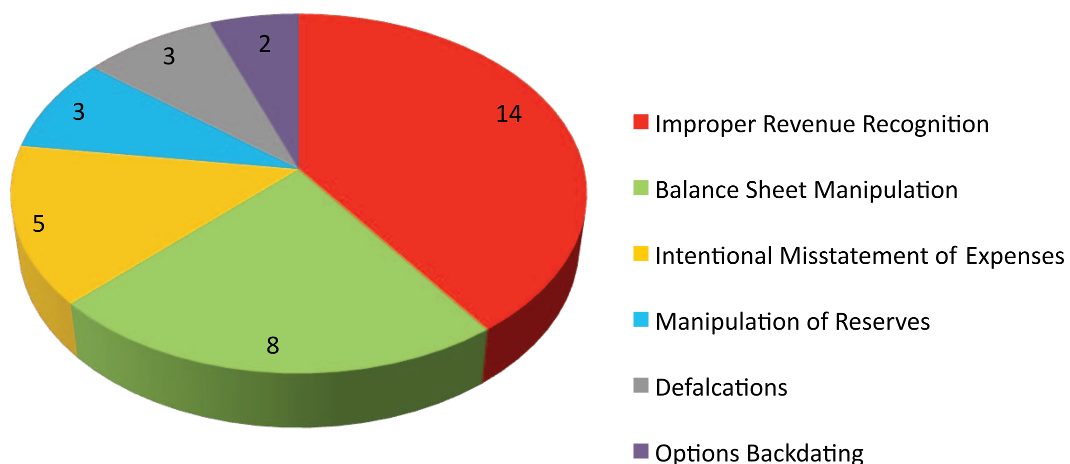
While it may be too simplistic to infer the difference between incurring a penalty and not incurring a penalty arises from the actions described above, it's indisputable that ArthroCare's efforts were favorably received by the SEC and beneficial to the resolution of the action.

The Q1 2011 AAER's; Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in the Q1 2011 AAER's we identified the accounting problem(s) in each AAER based on the classification definitions below:

Classification	Definition
Improper Revenue Recognition	Overstated, premature and fabricated revenue transactions reported in public filings
Manipulation of Reserves	Improperly creating, maintaining, and releasing restructuring reserves, general reserves, and other falsified accruals
Intentional Misstatement of Expenses	Deceptive misclassifications and understatements of expenses
Balance Sheet Manipulation	Misstatement and misrepresentation of asset balances, and the recording of transactions inconsistent with their substance
Options Backdating	Intentional misdating of stock option awards
Defalcations	Thefts of funds and assets

The following chart provides the results of our financial reporting issue analysis for the Q1 2011 AAER's. Improper revenue recognition was the most prevalent problem in the quarter.



Notable AAER's for "Recommended Reading"

While reviewing all the SEC's AAER's may prove insightful, certain releases have more beneficial and educational information than others and are worth 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.

For Q1 2011, we identified two AAER's for "recommended reading"; the KPMG Australia release regarding independence rule violations and the NIC, Inc. release involving fraudulent perks and payments for the company's CEO and the failure of the company's controls to identify and stop them.

Below we will provide an overview of the AAER's key facts, issues and our observations.

In the Matter of KPMG Australia, Administrative Proceeding File No. 3-14276

Needless to say, "Big Four" accounting firms are not generally the named party to an AAER; something that in and of itself elevates the significance of the enforcement action against KPMG Australia. The enforcement action relates to independence rule violations by KPMG Australia at two of their New York Stock Exchange audit clients. Conspicuously, the client's names are not provided, they are identified only as "Company A" and "Company B".

Before discussing the substance of auditor independence rules and the violations identified in the AAER, background and context are needed to appreciate a few key dates related to the underlying events:

- KPMG Australia served as the lead auditor of Company A's financial statements for its fiscal years 2001 through 2004, with independence violations identified by the SEC for late 2001 through 2002.

- KPMG Australia served as the lead auditor of Company B's financial statements for its fiscal years 2001 through 2004, with independence violations identified by the SEC for late 2001 through 2004.

- On March 4, 2004, the SEC commenced a formal investigation involving these matters with KPMG Australia.

- On February 28, 2011, the SEC issued the KPMG Australia AAER as an Order Instituting Public Administrative and Cease and Desist Proceedings Pursuant to Sections 4C and 21C of the Securities and Exchange Act of 1934 and Rule 102(e) of the SEC's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease and Desist Order.

Public registrants must file annual financial statements that have been audited by an independent certified public accountant with the SEC. The independence of the auditor from management of the company is critical to the trust and reliance placed on the auditor's opinion on the financial statements. A lack of independence by the auditor not only eliminates this trust and reliance, but importantly it negates the registrant's compliance with the securities laws to file annual audited financial statements; a situation only cured by conducting a new independent audit.

Per the SEC, the general standard of auditor independence is that the auditor is not independent if "a reasonable investor with knowledge of all the facts and circumstances would conclude that the auditor is not capable of exercising objective and impartial judgment on all issues encompassed within the audit engagement". Audit committees are responsible for this assessment and should consider whether relationships or services provided by the auditor:

- Creates a mutual or conflicting interest with their client,
- Places them in a position of auditing their own work,
- Results in their acting as management or an employee of the audit client, or
- Places them in a position of being an advocate for the audit client

The SEC and the PCAOB provide detailed guidance on the specific services and relationships that are prohibited and would negate an auditor's independence,

Examples of KPMG Australia's independence violations at Company A and Company B that are reported in the release include:

- During 2001 and the first half of 2002, providing at least thirty professionals to work at Company A in roles including "Market Operations Support and Control Manager", "Acting Senior Financial Controller, Personal Financial Services", a subsidiary "Acting CFO", and serving in functions including managing a life insurance accounting team, implementing a general ledger system, conducting loan file reviews as part of internal audit procedures that were relied on during the financial statement audit and preparing financial statements for a foreign subsidiary.

- During the period November 2000 through October 2003, providing at least twenty professionals to work at Company B to perform loan file portfolio functions in the credit restructuring unit which entailed reviewing loan files, meeting with customers, appointing third party advisors, developing and implementing strategy for recovery on the loans and supervising company personal in the process. The KPMG Australia personnel had Company B titles, business cards, used stationary, and in two instances the files worked on by the personnel were selected for audit procedures. A KPMG Australia partner served as the "Acting Global IT Audit Manager" and prepared information that he would later rely on as a member of the audit team when scoping out the substantive testing procedures for the company's information technology system. KPMG Australia collected commissions from a company acquired by Company B for recommending its products after the company became a subsidiary of Company B. A KPMG legal affiliate provided litigation services to Company B.

The AAER is informative and presents a robust discussion related to auditor independence failures and the importance of quality control systems in global firms operating in countries with diverse standards and rules. In fact, Australia's auditor independence rules during this time period appear much less stringent than those in the United States. Nevertheless, the United States rules dictate the requirements for registrants with securities registered with the SEC and traded on US exchanges.

The AAER may be as notable for the questions that it leaves unanswered including:

- Who is Company A and Company B?
- What did the audit committees of Company A and Company B know and should they bear responsibility?
- Why did the SEC investigation start in 2004 and finish in 2011?
- Was there a conscious delay to avoid the burden of a new audit being performed?
- Is this a unique situation or are there other unreported and undetected independence problems in the client base of the global auditing firms?

Interestingly, this release doesn't appear to have received much public attention, maybe due to the outdated filings or maybe because people feel the situations described above were so unusual that they wouldn't happen again. In any case, audit committee members should read this release to ask informed questions about their auditor's independence.

Speech before the American Accounting Association, Auditing Section January 15, 2011

"Under Sarbanes-Oxley, regulation by the PCAOB is based on a supervisory or prudential approach with its emphasis on remediation. Specifically, quality control deficiencies identified in an inspection are not made public if they are corrected to the satisfaction of the Board within twelve months of the issuance of an inspection report. This, of course, is very different from the SEC's regulatory approach which is more enforcement-based. Saying this, I quickly want to emphasize that the PCAOB has a robust enforcement program, although I realize it looks like a black box from outside. This is because Sarbanes-Oxley prohibits disclosure of PCAOB enforcement actions until the SEC acts on appeals. If justice delayed is justice denied, so too investors are not well-served if useful information – in this case enforcement information – is not made available in a timely manner. There have been cases where firms have issued numerous audit reports while enforcement actions were pending, meaning that investors and issuers had no way to know that the PCAOB considers the firm's work to be substandard."

by Bill Gradison
Public Company Accounting Oversight Board Member

SEC v. NIC, Inc., Jeffrey S. Fraser, Harry H. Herrington, and Eric J. Bur, Civil Action No. 2:11-CV-02016 (EFM) (D. Kansas Jan. 12, 2011) and SEC v. Stephen M. Kovzan, Civil Action No. 2:11-CV-02017 (JWL) (D. Kansas Jan. 12, 2011)

The release describes deceptive and misclassified perks and payments using company funds for the benefit of NIC, Inc.'s former CEO, Jeffrey S. Fraser starting in 2002 and continuing through 2007.

The overriding lesson in the release is the peril to one's career and reputation when working in a company with "tone at the top" problems. In addition to the charges filed against the former CEO, the current CFO and former CAO, Kovzan, the current CEO and former COO, Herrington, and the former CFO, Bur, were all charged with failing to disclose the perks and for filing false misleading statements.

The allegedly undisclosed payments to and for the CEO included monthly payments for a ski lodge in Wyoming, and monthly payments to rent a house in Kansas, owned by an entity set up by Fraser, which also raises related party disclosure issues. Moreover, Fraser purportedly received vacations for his girlfriend and family, in addition to quite a long list of items that represented an

extravagant lifestyle, many of which appear to be personal expenses such as flight training, hunting, spa services, skiing, health club expenses, computers, a leased car, commuting costs on a private jet, and day to day living expenses such as groceries, liquor, tobacco, nutritional supplements and clothing.

Per the allegations, Fraser routinely used his company credit card for personal expenses then falsified expense reports claiming the charges were business related. Most troubling was the allegation that certain individuals identified above may have had knowledge of the abuses, allowed the internal controls to be subverted, and for the company to make false statements in their public filings. The release even describes an unidentified finance person who in 2006 raised concerns about possible tax fraud problems due to the perks but no action was taken. Furthermore, the release mentions a whistleblower warning that went without corrective action, but there is insufficient information as to whether the audit committee was involved and if so, why they took no action.

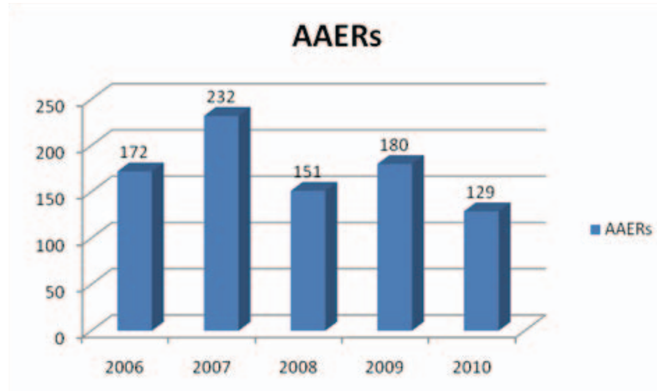
Per the release, the systems and safeguards at NIC, Inc failed to protect the shareholders and the people in positions of responsibility failed to stand up to an overly aggressive CEO whose "tone at the top" conduct should certainly have raised concerns. The internal controls were allegedly overridden and documents were falsified and the corporate governance system appears to have failed as well, based on the SEC action noting the warnings that were ignored.

For financial reporting and disclosures, the current requirement to report executive perks are contained in Regulation S-K Item 402(c)(2)(ix)4, and the relevant section reads:

> "If the total value of all perquisites and personal benefits is $ 10,000 or more for any named executive officer, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a named executive officer pursuant to this rule, then each perquisite or personal benefit that exceeds the greater of $ 25,000 or 10% of the total amount of perquisites and personal benefits for that officer must be quantified and disclosed in a footnote."

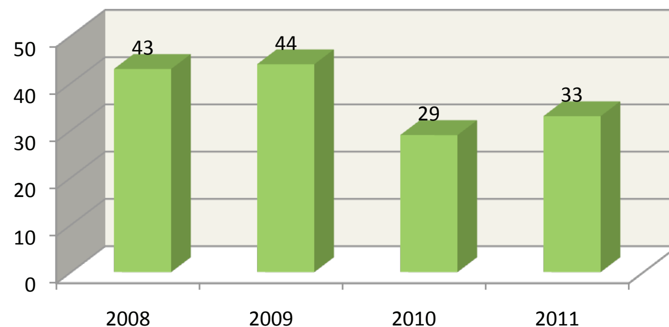
One issue that is unclear from the release is whether Mr. Fraser's talents and skills warranted the total value of the compensation that he provided himself. Interestingly, given that he undertook such deceptive actions would lead one to believe that he himself doubted he was worth the pay package or else he would have presented it to the compensation committee and the board of directors of NIC, Inc. All parties charged by the SEC have settled without admitting or denying fault except Mr. Kovzan, who is fighting the SEC allegations.
CORRECTED SEPTEMBER 2012

Prior Period Comparisons; Year over Year and Quarter over Quarter Statistics



As described in our Process and Methodology section, AAER's 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 the SEC provides for the classification. That said, comparisons of the number of AAER's between periods can be a useful gauge of the SEC's activities.

During 2010, the SEC issued 129 AAER's, remarkably the lowest number of AAER's for the prior five year period. For comparison, the SEC issued 180 AAER's in 2009 and the average of the prior four years from 2006 through 2009 was 183; both numbers indicating an approximate thirty percent reduction in AAER's for 2010.



The first quarter of 2011 however is showing signs that this trend may be changing.

When analyzing the AAER population issued during the first quarters for the years 2008 through 2011, the 2011 result show an increase of approximately 14 % over 2010, although still approximately 25 % lower than the 2009 population.

Acknowledgement

We wish to acknowledge the valuable contribution to this analysis by Janet M. Floyd, CFE and Elizabeth Gingrich.

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About Floyd Advisory LLC

Floyd Advisory LLC is an independent boutique forensic accounting and business advisory firm headquartered in New York City, providing services relating to; financial reporting problems, fraud investigations, SEC reporting issues, white collar defense matters, post-acquisition disputes, business damages, financial and valuation analyses.

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