



*Summary of Accounting and
Auditing Enforcement Releases
for the Quarter Ended
September 30, 2012*

Q 3 R E P O R T 2 0 1 2

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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 ending September 30, 2012.

As an independent business advisory and forensic accounting 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 concerning civil litigation and administrative actions that are identified as “accounting and auditing” related, 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 any requests for additional analysis you would find helpful.

Floyd Advisory LLC
OCTOBER 2012



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”). Importantly, 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, which is based solely on information provided by the SEC, we sorted the releases into major categories (e.g., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations (“FCPA”), Reinstatements to Appear and Practice before the SEC and Other) and classifications of the financial reporting issues involved (e.g., 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 of the key facts in each release.

REVIEW PROCESS

- Gathered information and key facts
- Identified common attributes
- Noted trends
- Observed material events
- Sorted the releases into major categories
- Prepared a database of the key facts

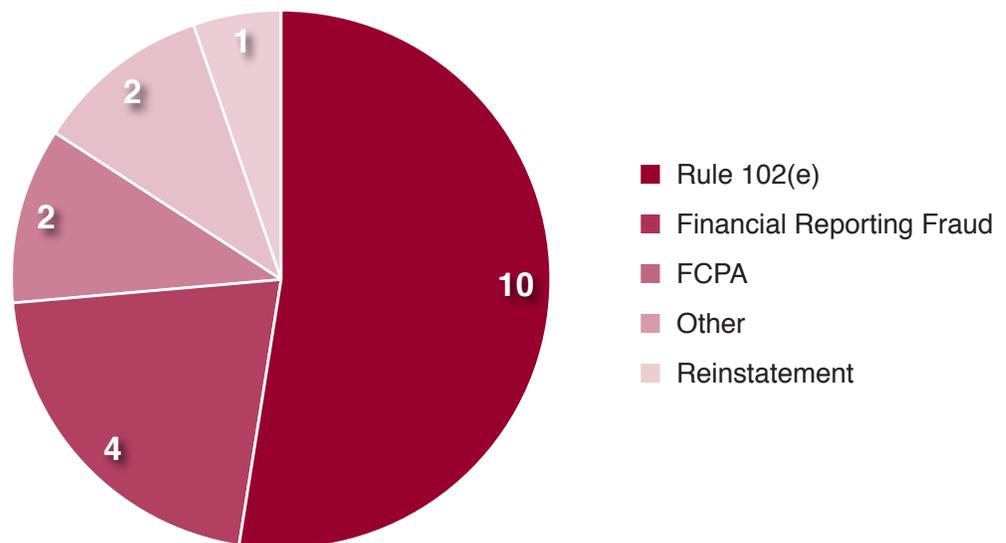
The Q3 2012 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed nineteen AAERs during Q3 2012, which we have sorted into the following categories, as shown in the pie chart. Notably, individual sanctions dominated this quarter's results, with 53% of the releases being categorized as Rule 102(e) sanctions. While seeing the categorical breakdown is analytically useful, a closer look into each category provides a clearer understanding of the SEC's actions.

AAERs reported for
Quarter Ended
September 30, 2012:

19

AAERs by Category



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 or 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 that indicate a lack of competence.

Notably, of the ten individuals receiving Rule 102(e) sanctions during Q3 2012, seven were certified public accountants. The problems underlying these sanctions included violations of the Advisors Act, involvement in fraudulent offer and sale of unregistered securities, issuing unregistered private placement memoranda including misrepresentations, insider trading and financial reporting fraud schemes. The following releases are worth highlighting:

- ***The former SEC Reporting Manager of Marvell Technology Group, Ltd. (“Marvell”) allegedly participated in an insider trading scheme from 2002 through 2010 by providing certain individuals with material, nonpublic information regarding the financial performance of Marvell.*** In May 2008, the individual allegedly supplied sensitive information regarding Marvell’s quarterly earnings to his friends, who then engaged in securities trades, prior to the company disclosing the information to the public. The allegations represent a direct violation of the duty owed to Marvell to keep all material nonpublic information concerning the company confidential and a blatant violation of the company policy that strictly prohibits the leaking of material nonpublic information to persons outside of Marvell.
- ***The SEC alleged that the former chief financial officer (“CFO”) of Veritas Software Corporation (“Veritas”) artificially inflated reported revenues by approximately \$20 million in connection with a software sale to America Online, Inc. (“AOL”) in 2000.*** According to the complaint, Veritas’ former CFO applied an accounting treatment to the transaction that did not comply with generally accepted accounting principles (“GAAP”). The complaint also alleged that the former CFO and others concealed the true nature of the transaction with AOL, allowing Veritas to artificially inflate its reported revenue. The complaint stated that from at least 2000 until the CFO’s resignation in 2002, the former CFO and others applied three non-GAAP accounting practices to artificially “smooth” Veritas’ financial results and concealed these manipulations from Veritas’ independent auditors.
- ***The SEC filed charges based on allegations that the former CFO and other individuals working at NutraCea, Inc. (“NutraCea”) overstated the sales revenues for NutraCea’s 2007 fiscal year by booking false sales and engaging in improper revenue recognition practices.*** The complaint stated that former CFO violated the antifraud books and records, and internal controls provisions of the federal securities laws because he knew or was reckless in not knowing that NutraCea improperly accounted for a \$2.6 million sale in the second quarter of 2007 and a \$1.9 million sale in the fourth quarter of 2007. The complaint also stated that the former CFO signed false management representation letters to NutraCea’s auditors.

Notably, of the ten individuals receiving Rule 102(e) sanctions during Q3 2012, seven were certified public accountants.



**SPEECH BY SEC
COMMISSIONER:
INCREASING THE
VULNERABILITY OF
INVESTORS**

“In most cases, much of investors’ monies are long gone by the time a fraud is identified and an action can be brought. It is the Commission’s job to prevent investors from being harmed. True investor protection requires mechanisms to deter and prevent fraud before it begins.”

Commissioner Luis A. Aguilar
SEC Open Meeting
August 29, 2012

- **An administrative proceedings order was filed against a certified public accountant (“CPA”) licensed in the state of California, who was a principal at the accounting firm Vasquez & Company, LLP (“Vasquez”) and served as the engagement partner on the audit of Soyo Group, Inc. (“Soyo”).**

The individual allegedly failed to ensure that the Vasquez engagement team conducting Soyo audit abided by the Standards of the Public Company Accounting Oversight Board related to debt obligations and going concern matters. Notably, the individual’s alleged improper professional conduct included: failure to obtain sufficient competent evidential matter, failure to properly consider Soyo’s ability to continue as a going concern, failure to modify the auditor’s report appropriately when Soyo did not make required disclosures, failure to act with due professional care, failure to prepare and maintain adequate work papers, and failure to adhere to standards of conducting reviews of interim financial information.

- **A judgment was entered against the CFO, chief operating officer (“COO”), chief accounting officer (“CAO”) and secretary of Spongetech Delivery Systems, Inc. (“Spongetech”) by consent, in the civil action brought by the United States District Court of the Eastern District of New York. The SEC’s complaint alleged that at the beginning of April 2007, the CFO and others engaged in a profit making scheme to illegally increase demand for the unregistered sale of publicly-traded stock in Spongetech.**

The SEC claims that these individuals were “pumping” up demand for Spongetech stock through false public statements about non-existent Spongetech customers, fictitious sales orders, and phony revenue. In addition, it is alleged that these individuals repeatedly and fraudulently understated the number of Spongetech’s outstanding shares in press releases and public filings. The purpose of flooding the market with false public information was to fraudulently inflate the price for Spongetech shares so the CFO and others could then “dump” the shares by illegally selling them to the public through affiliated entities in unregistered transactions. The complaint further alleged that Spongetech, at the direction of the CFO and a codefendant, filed periodic reports with the SEC that contained materially false and misleading statements, overstated revenues and false purchase orders, invoices and other documents. Furthermore, Spongetech failed to maintain accurate books and records or implement effective internal controls.

- **The SEC filed a complaint against a CPA licensed to practice by the state of Arizona, alleging the CPA was in violation of federal securities laws.**

The complaint further claimed that in connection with the sale of approximately \$11.9 million of securities to approximately 169 investors, this individual made material misrepresentations and omissions regarding, among other things, the value of company assets. The alleged misrepresentations and omissions were contained in private placement memoranda (“PPMs”) used in unregistered offerings. The complaint alleged that the individual participated in drafting and providing content for the PPMs as well as soliciting investors. In addition, it alleged that the offering violated federal security laws by wrongfully relying on the registration exemption pursuant to Regulation D, Rule 506. The complaint stated that the offerings did not meet the Regulation D, Rule 506 requirements because the securities were offered through general solicitation.

Financial Reporting Frauds

As reflected in the chart on page 2, there were four AAERs that are categorized as financial reporting frauds during the quarter. The fraud issues discussed in the China Sky Medical, Inc. AAER are of such significance that we will discuss them in detail in our “Recommended Reading” section. Other actions related to financial reporting frauds described in the releases this quarter include:

- ***In the SEC release pertaining to TierOne Bank (“TierOne”), the SEC charged three former bank executives in Nebraska with participating in a scheme to understate millions of dollars in losses and mislead investors and federal regulators at the height of the financial crisis.*** Furthermore, one of the executives and his son were allegedly involved in insider trading. The SEC alleged that former Chief Executive Officer (“CEO”) and chairman, along with the president and COO, and chief credit officer (“CCO”), played a role in understating loan-related losses and losses on real estate that had been repossessed by the bank. TierOne branched out into markets where high risk lending was prevalent including Las Vegas as well as high growth markets such as Arizona and Florida. These actions inevitably resulted in a significant rise in high-risk problem loans for the bank. According to the release, TierOne’s primary banking regulator, the Office of Thrift Supervision, instructed TierOne to maintain higher capital ratios as a result of the bank’s increase in high-risk problem loans. In an attempt to appear in compliance with these heightened capital requirements, the aforementioned former senior officers allegedly disregarded information indicating that the collateral, for certain TierOne loans and real estate repossessed by the bank, was overvalued based on the bank’s reliance on stale and inadequately discounted appraisals. The losses were allegedly understated by millions of dollars and were documented in multiple SEC filings.
- ***The SEC charged Gold Standard Mining Corp. (“Gold Standard”) with allegedly filing numerous materially false and misleading reports between May 2009 and April 2011 pertaining to its purported gold mining operations in Russia.*** According to the complaint, Gold Standard indicated that it had acquired a Russian gold mining company known as Ross Zoloto Co., Ltd. (“Ross Zoloto”), but neglected to inform investors about an agreement to allow the previous owner of Ross Zoloto to retain profits from existing operations. Investors also were not informed of Gold Standard’s failure to register the acquisition with Russian regulatory authorities. In addition, investors were allegedly never given the opportunity to approve the Ross Zoloto acquisition.

Individual sanctions
dominated for
Quarter Ended
September 30, 2012:
53%

FCPA Violations

There were two FCPA related releases in Q3 2012: a matter involving Pfizer Inc. (“Pfizer”), a global pharmaceutical company and an action against Tyco International Ltd. (“Tyco”), an international manufacturing company.

Key facts in the Pfizer and Tyco releases are as follows:

- ***The SEC filed a settled enforcement action against Pfizer for violating the FCPA when Pfizer subsidiaries allegedly bribed doctors and other health care professionals employed by foreign governments in order to win business.*** Pfizer is a global pharmaceutical company that discovers, develops, manufactures and markets prescription medicines for humans and animals. The SEC alleged that employees and agents of Pfizer’s subsidiaries in Bulgaria, China, Croatia, Czech Republic, Italy, Kazakhstan, Russia and Serbia made improper payments to foreign officials to obtain regulatory approvals, sales and increased prescriptions for the company’s pharmaceutical products. Attempts were made to conceal the bribery by improperly recording the transactions in accounting records as legitimate expenses for promotional activities, marketing, training, travel and entertainment, clinical trials, freight, conferences, and advertising. While the improper payments were made without the knowledge or approval of officers or employees of Pfizer, the subsidiaries’ financials were incorporated in Pfizer’s consolidated financial statements. Pfizer failed to devise and maintain an appropriate system of internal accounting controls.

The SEC filed a separate settled enforcement action against another pharmaceutical company Wyeth LLC (“Wyeth”), that Pfizer acquired several years ago, for its own FCPA violations. Pfizer and Wyeth have agreed to separate settlements in which they will pay approximately \$45 million combined in disgorgement and prejudgment interest to the SEC to settle their respective charges. In a related action, Pfizer H.C.P. Corporation, an indirect wholly owned subsidiary of Pfizer, will pay a \$15 million penalty to settle FCPA charges brought against it by the U.S. Department of Justice under a deferred prosecution agreement.



**SPEECH BY SEC
COMMISSIONER:
INCREASING THE
VULNERABILITY OF
INVESTORS**

“History shows that, when stock promoters are allowed to advertise and solicit the public without any sort of registration or qualification whatsoever, it opens the door to fraudsters and scam artists of every description.”

Commissioner Luis A. Aguilar
SEC Open Meeting
August 29, 2012

- ***The SEC filed a settled civil action against Tyco for violating the books and records, internal controls, and anti-bribery provisions of the FCPA.*** Tyco is an international manufacturing company based in Switzerland with securities listed on the New York Stock Exchange. The SEC's complaint alleged that from 2006 to 2009 Tyco subsidiaries operated twelve illicit payment schemes. Many of the schemes involved fake commission payments and the use of third-party agents to improperly funnel money. The complaint further alleged that Tyco's books and records were misstated as a result of the misconduct and that Tyco failed to devise and maintain internal controls sufficient to detect the violations. The complaint also stated that payments made by a sales agent to Turkish government officials violated the anti-bribery provisions of the FCPA. According to the complaint, Tyco voluntarily disclosed this conduct to the SEC and thereafter took extensive remedial measures, including firing the employees involved in the misconduct, exiting certain lines of business, and making significant enhancements to its FCPA compliance program.

Reinstatement

During Q3 2012, one CPA was reinstated to appear and practice before the SEC. The accountant's suspension arose from making material misstatements and omissions to investors in several unregistered offerings concerning the use of proceeds. The CPA was licensed to practice in the State of Massachusetts and served as CFO of U.S. Gas & Electric, Inc. ("U.S. Gas") from December 2002 until September 2004, then becoming the company's CEO. Specifically, the complaint alleged that U.S. Gas, with the participation of its CEO and other officers, failed to disclose to investors that excessive commissions were being paid to telemarketers from offering proceeds. Furthermore, U.S. Gas made misrepresentations to investors in one of the offerings regarding the amount of management fees that would be paid out of investor funds.

During Q3 2012, one CPA was reinstated to appear and practice before the SEC.

The Q3 2012 AAERs: Summary of Financial Reporting Issues



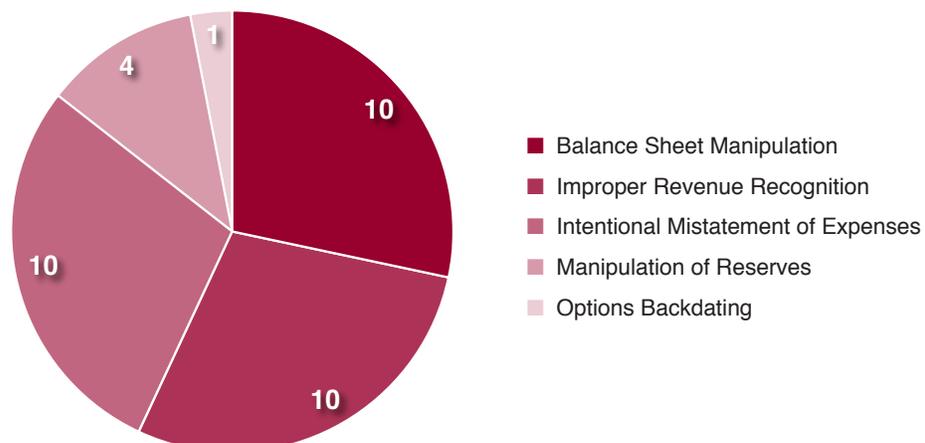
To report on the frequency of financial reporting issues involved in Q3 2012 AAERs, we identified the accounting problem(s) in each AAER based on the classification definitions below:

Classification	Definition
Improper Revenue Recognition	Overstated, premature and fabricated revenue transactions reported in public filings
Manipulation of Reserves	Improperly created, maintained and released 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

Balance Sheet Manipulation, Improper Revenue Recognition and Intentional Misstatement of Expenses were the most prevalent issues in the quarter.

The following chart provides the results of our financial reporting issue analysis for the Q3 2012 AAERs. Balance Sheet Manipulation, Improper Revenue Recognition and Intentional Misstatement of Expenses were the most prevalent issues in the quarter.

AAERs by Financial Reporting Issue



Notable Q3 2012 AAERs for “Recommended Reading”

While reviewing all of the SEC’s AAERs may prove insightful, certain releases present information that is worth further review and analysis by those involved with financial reporting matters. We deem these particular releases “Recommended Reading” for our clients.

For Q3 2012, we identified two AAERs for “Recommended Reading”: the Huron Consulting Group Inc. (“Huron”) release, a case involving improper accounting related to “earn out” amounts arising from business acquisitions and the China Sky One Medical Inc. (“CSKI”) release, a financial fraud case involving the fabrication of export sales and the material overstatement of financial results.

Huron Consulting Group Inc., Gary L. Burge, CPA, and Wayne E. Lipski, CPA Administrative Proceeding, File No. 3-14958

For all involved in accounting for business combinations and purchase price allocations, the Huron AAER is more than “recommended reading”; it is mandatory reading material, especially to appreciate the complexity and need for controls related to accounting for transaction consideration.

The SEC charged the Chicago-based consulting firm and two of its former executives with overstating the company’s income for multiple years due to the accounting for contingent payments arising from business acquisitions. The problem at Huron arose when shareholders of Huron’s acquired businesses received acquisition sales proceeds from Huron in the form of earn outs and shareholders subsequently redistributed a portion of the monies to other Huron employees and amongst themselves (“Redistributions”). Huron treated the entirety of the payments as goodwill and did not record compensation expense for the payments ultimately received by employees who were not the shareholders of the acquired business, violating GAAP.

For each of these Redistributions, Huron should have recorded compensation expense because the Redistributions were (1) contingent on the employees’ continued employment with Huron, (2) based on the achievement of personal performance measures, or (3) were not “clearly for a purpose other than compensation.” By failing to do so, Huron overstated its pre-tax income to the public. Per the release, accounting decisions at Huron were overseen by the former CFO, and former controller and CAO.

According to the release, Huron’s financial statements for 2006, 2007, 2008 and the first quarter of 2009 were materially misstated as a result of these accounting failures. In August 2009, Huron restated those financial statements, thus reducing its net income by approximately \$56 million.

For all involved in accounting for business combinations and purchase price allocations, the Huron AAER is more than “recommended reading”; it is mandatory reading material, especially to appreciate the complexity and need for controls related to accounting for transaction consideration.



In simple terms, the ***Redistributions that were subject to continuing employment requirements should have been considered compensation payments made for the benefit of Huron.*** Huron’s restatement concluded that those Redistributions related to an individual’s performance within Huron subsequent to the acquisition or that were not “clearly for a purpose other than compensation for the services” to Huron, were considered compensation payments made for services provided to Huron. As with many aspects of GAAP, substance always wins over form.

SEC v. China Sky One Medical, Inc. and Yan-qing Liu, United States District Court for the Central District of California (Civil Action No. CV12-7543 MWF (MANx))

The SEC alleged CSKI falsely stated in its 2007 annual and quarterly reports that it had entered into a strategic distribution agreement with a Malaysian manufacturer and retailer, Takasima Industries (“Takasima”), that would become the “exclusive” distributor of CSKI’s “slim patch” in Malaysia and was expected to generate \$1 million per month in sales. However, the company never actually entered into any such agreement. CSKI instead created approximately \$19.8 million in phony export sales to Malaysia and recorded this revenue in its financial result for 2007 and 2008. CSKI’s CEO certified the overstated financial results that appeared in the financial statements through 2010.

According to the SEC’s complaint, CSKI is based in Harbin, China. In addition to weight loss patches, the company produces and sells sprays, ointments and other Chinese traditional pain relief and health and beauty products. CSKI became a public company trading on the U.S. markets through a reverse merger in May 2006.

The SEC alleged that after CSKI devised the purported strategic distribution agreement with Takasima, a fitness equipment manufacturer and retailer, CSKI then falsely reported export sales to Malaysia of more than \$12.2 million in 2007 (25 percent of total 2007 revenues) and \$7.5 million in 2008 (8.2 percent of total 2008 revenues). Virtually all of CSKI’s reported sales to Malaysia via Takasima were fictitious. In reality, Takasima only purchased \$167,542 in slim patches from CSKI in 2007 and none in 2008. Takasima never entered into any distribution agreement with CSKI and never undertook any minimum purchase commitment.

According to the SEC’s complaint, CSKI also falsely claimed in its public filings that its top two customers for 2007 were sales agents for Takasima. CSKI identified those customers as Ningbo Yuehua International Trading Company and Guangzhou Xinghe International Trading Company, whose purchases collectively accounted for the phony 25 percent of CSKI’s total revenues for 2007. CSKI claimed that all of these purported sales to Ningbo Yuehua and Guangzhou Xinghe went through Takasima, while in fact Takasima never had any relationship with these two entities.

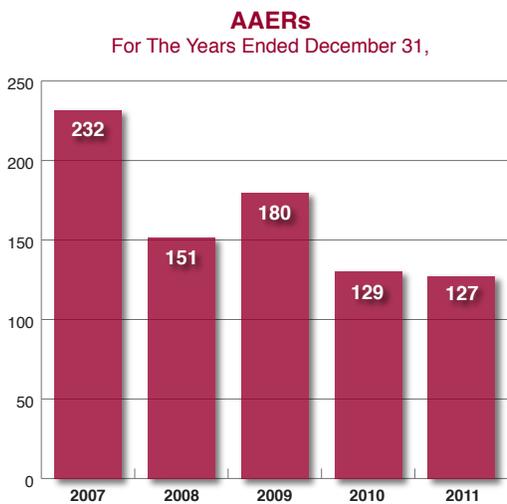
**SPEECH BY PCAOB
MEMBER: INVESTOR
PROTECTION THROUGH
AUDIT OVERSIGHT**

“Seven years of international inspections have revealed that too often auditors are missing some basic things and making troubling errors, including errors in the timing and documentation of a company’s revenue recognition; overreliance on managements’ estimates of such things as contingency and warranty reserves, allowances for doubtful accounts in financial institutions, hard to value financial instruments, and obsolete of overvalued inventory.”

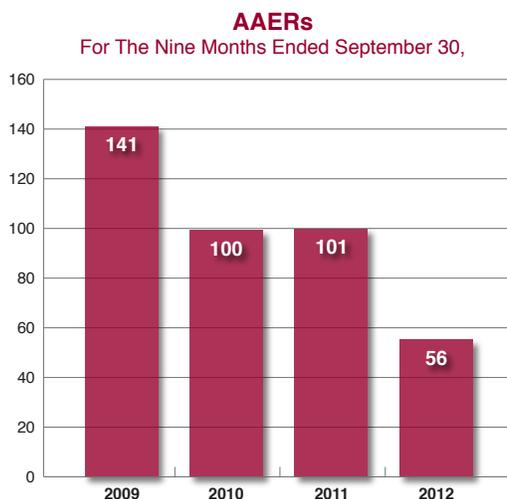
Lewis H. Ferguson,
Board Member
California State University
11th Annual SEC Financial
Reporting Conference
Sept. 21, 2012

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

As described in “Our Process and Methodology” section, 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 the SEC provides for the classification. Nevertheless, comparisons of the number of AAERs between periods may be a useful gauge of the SEC’s activities.



For the year ending December 31, 2011, the SEC issued 127 AAERs, remarkably the lowest number of AAERs reported over the last five years. For comparison, the average for the annual periods from 2007 through 2011 was approximately 164 releases, with the greatest number of releases issued in 2007.



When analyzing the AAER population issued during the first nine months of the years 2009 through 2012, the results show a substantial decrease over time. While the trend in AAER designations may be down, the content and usefulness of those identified continues to be of great value to the financial reporting community for informational and educational purposes.

**AAERs reported for
Year Ended
December 31, 2011:**
127

**AAER population
issued for The
Nine Months Ended
September 30, 2012:**
56

www.floydadvisory.com

ACKNOWLEDGEMENT

We wish to acknowledge the valuable contribution to this analysis by Liz Klyuchnikova, Sarah Floyd, Saro Banoian and Elizabeth Gingrich.

ABOUT Floyd Advisory

Floyd Advisory LLC is an independent business advisory and forensic accounting firm with offices in Boston and 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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