



*Summary of Accounting and
Auditing Enforcement Releases
for the Quarter Ended
September 30, 2016*

Q 3 R E P O R T 2 0 1 6

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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 September 30, 2016.

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
OCTOBER 2016

The Q3 2016 AAERs: Highlights

- Rule 102(e) violations once again represent the largest group of releases for this quarter. The fourteen releases led to suspensions for twenty individuals, five of whom were auditors.
-
- The Foreign Corrupt Practices Act (“FCPA”) continues to lead in terms of penalties, with total Q3 penalties of \$58.8M exceeding the \$54.6M in total penalties from the first two quarters of 2016 combined.
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- A particularly noteworthy reinstatement of an individual by the SEC led us to examine historical data related to 102(e) suspensions and reinstatements spanning the past five years. Our analysis accompanies discussion of this reinstatement and can be found in the Recommended Reading section.

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.

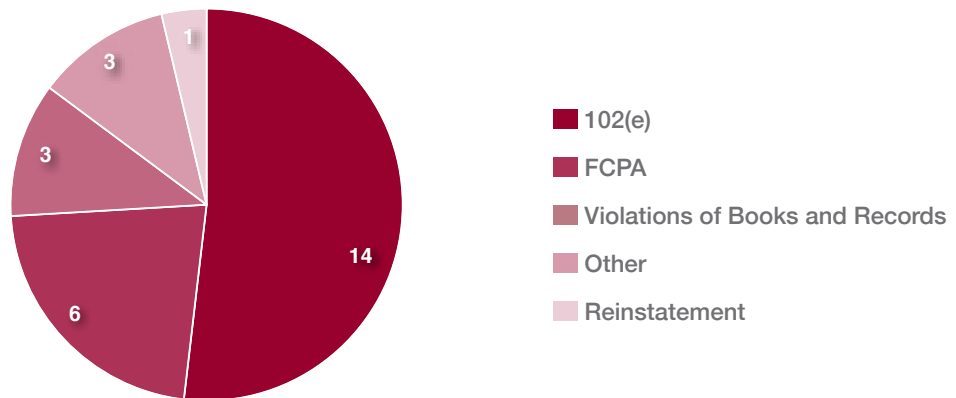
To meet our objective of summarizing the major items reported in the AAERs, we reviewed those releases identified and disclosed by the SEC on its website, www.sec.gov.

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 (e.g., 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), and classifications of the financial reporting issues involved (e.g., Improper Revenue Recognition, Manipulation of Reserves, Intentional Misstatement of Expenses, Balance Sheet Manipulation and Errors, 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.

The Q3 2016 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed twenty-seven AAERs during Q3 2016, with Rule 102(e) actions representing just over 50% of the total releases. Twenty individuals were issued 102(e) suspensions as a result of those fourteen cases. Of the fourteen total cases, four were audit-related and included actions against five individual auditors and two CPA firms involved in financial statement audits.

Q3 AAERs by Category



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.

The SEC accepted respondents' offers of settlement in twelve of the fourteen AAERs involving Rule 102(e) violations during Q3. In ten of the twelve settled enforcement actions, the sixteen respondents involved settled without admitting or denying the SEC's findings. The remaining two settled enforcement actions each involved a single respondent and stipulated that they admit to the SEC's findings. Orders of forthwith suspensions were issued in the remaining two unsettled enforcement actions.

“One of the most important remedial tools we have to ensure accountability for audit quality and auditor independence is Rule 102(e) of the Commission’s Rules of Practice. The Commission adopted Rule 2(e), the predecessor to Rule 102(e), in 1935 under its general rulemaking powers as a “means to ensure that those professionals, on whom the Commission relies heavily in the performance of its statutory duties, perform their tasks diligently and with a reasonable degree of competence.”

Andrew Ceresney
Director of the SEC’s
Division of Enforcement
Washington, DC
September 22, 2016

The SEC Enforcement Division’s
Focus on Auditors and Auditing

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

- For five years, two employees of a large multinational provider of oil and natural gas equipment and services issued allegedly false and misleading financial statements.** According to the SEC, the company's financial statements reflected inflated earnings in violation of GAAP. The statements allegedly included falsified and misleading disclosures of net income, earnings per share, and effective tax rate, among other key financial metrics. The SEC also claimed the company's internal accounting controls were insufficient to properly account for the company's income taxes during the five-year period in question. The company, therefore, was required to restate its financial statements on three separate occasions during an eighteen-month period. Alleged orchestrators of a four-year income tax accounting fraud were the company's vice president of tax and a senior manager of tax who later became a director of tax during the relevant period. The respondents to the SEC's claims allegedly made post-closing adjustments in an attempt to meet effective tax rate targets that had previously been publicly disclosed. These alleged practices were not in compliance with GAAP and allegedly overstated the company's earnings while understating its tax expense.
- The SEC charged a financial services firm and its four corporate officers with several violations of Securities and Exchange Acts.** The publicly traded bank holding company was allegedly not adhering to impaired loan disclosure requirements in accordance with GAAP. According to the claim, the failure to make appropriate disclosures was due in part to the negligence of the corporate officers named in the release, but also due to the company's lack of sufficient internal accounting controls. As a result, the company allegedly made material misstatements in their impaired loan disclosures in both their quarterly and annual filings spanning a period of two years. In addition, the claim states the company did not calculate loan losses in compliance with GAAP and allegedly applied GAAP incorrectly when calculating the fair value of collateral in connection with its impairment analyses. The SEC also claimed the company failed to properly implement a newly issued accounting pronouncement in one of its filings during the time period in question. The firm's corporate officers named in the release were the chief executive officer, former chief financial officer, chief accounting officer, and former chief credit officer.
- The sole director serving as both president and chief executive officer of a pharmaceutical company allegedly engaged in a fraudulent scheme** that amassed over \$12.2 million in alleged illegal stock sales over three years. Another officer, who was a CPA whose identity and role were not disclosed, allegedly also took part in the alleged scheme in which the company improperly recognized proceeds from the illegal stock sales as revenue and reported the revenue in press releases, financial statements, and on over-the-counter market websites. According to the SEC, the company used backdated convertible notes and preferred stock to issue common stock to unaffiliated entities controlled by the undisclosed corporate officer. The respondent in the claim settled and admitted to the SEC's findings. The respondent also later pled guilty to criminal conduct in proceedings related to the scheme and agreed to additional proceedings to determine what, if any, disgorgement and/or civil penalties will be assessed.
- The chief financial officer of an investment advisory firm allegedly engaged in a scheme to cover up the misappropriation of \$3.1 million of public employee pension funds.** According to the SEC release, the company's chief executive officer used misappropriated funds to purchase two retail shopping centers on behalf of company affiliates. The SEC claims that when the chief financial officer, also a five-percent shareholder of the company, learned of the misappropriation, he proceeded to conceal it from the pension fund rather than disclose his findings. Along with other

"The Commission amended Rule 102(e) in 1998 to clarify that, for licensed accountants, "improper professional conduct" includes, along with intentional, knowing, or reckless conduct, two kinds of negligent conduct — a single act of "highly unreasonable conduct" in circumstances warranting "heightened scrutiny" or "repeated instances of unreasonable conduct ... indicat[ing] a lack of competence to practice before the Commission."

Andrew Ceresney
Director of the SEC's
Division of Enforcement
Washington, DC
September 22, 2016

The SEC Enforcement Division's
Focus on Auditors and Auditing

company principals, he allegedly devised a plan to pay the fund back without ever informing the pension fund of the theft. Without admitting or denying the findings outlined in the complaint, the respondent settled with the Commission.

- ***The SEC settled with the chief financial officer of a financial services company's broker-dealer arm for his role in the company's failure to keep accurate books and records.*** The Commission alleged that the company's chief financial officer improperly carried out the monthly close process of the company's books by directing others to record unsubstantiated entries. These entries were made to at least one of the company's general ledger accounts and allegedly led to an overstatement of assets and income. The claim states that these overstatements impacted the company's annual audited reports and accompanying financial statements filed with the Commission. These allegedly inaccurate financial statements were also included in the company's monthly reporting to the Financial Industry Regulatory Authority ("FINRA"), which were then used to assemble SEC filings over the course of several months. According to the SEC, the company's annual audited report for fiscal year 2011 included a disclosure acknowledging an unsubstantiated asset balance in excess of \$13 million.
- ***A certified public accountant entered into settlement with the SEC related to allegations of improper professional conduct.*** According to the release, the respondent was a partner at a public accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB") and was also the engagement partner for several audits of a now-bankrupt manufacturer of computer hardware. The SEC claims that over the span of two years, audits were not conducted in accordance with PCAOB standards. The alleged failure to meet auditing standards related to the respondent's review of the manufacturer's inventory valuation accounting and sales return reserve activity, among other things. According to the SEC, during the two-year period, the manufacturing company dramatically overstated its revenues and gross profits which led to a restatement of its financial statements one year later. Shortly after this restatement, the company filed for bankruptcy protection, liquidated its assets, and is no longer operating. The commission filed separate complaints against the company's chief executive and financial officers.

FCPA Violations

There were six FCPA-related releases in Q3 2016, resulting in almost \$59 million in disgorgement, interest, and penalties that included a \$12.8 million criminal fine as part of a settlement with the United States Department of Justice.

- ***The SEC charged a global beer brewer and distributor with violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA").*** The violations occurred at the company's wholly owned subsidiary in India. For three years, the entity that managed marketing and distribution for the company's subsidiary in India allegedly made improper payments to Indian government officials. The SEC claims this entity then invoiced the company's subsidiary for the payments, which were paid in some cases and accrued in others, but recorded nevertheless on the books as legitimate promotional costs. According to the SEC, the company's subsidiary lacked adequate internal accounting controls to detect and prevent any improper payments and properly classify transactions involving third parties. This issue allegedly impacted the books of both the company and the subsidiary. Per the SEC's claim, the subsidiary terminated an employee and, in the separation agreement, restricted the employee's ability to communicate directly with the Commission staff about possible securities law violations. The company has also employed this practice in previous instances. The settlement with the SEC did not require the company to admit any wrongdoing, but it did require payment of monetary penalties in excess of \$6 million including disgorgement, interest, and a civil penalty.

"To effectively combat bribes paid by global companies that benefit from access to our capital markets by listing their stock on U.S. exchanges, the SEC is often dependent on our international counterparts to provide vital cooperation and assistance. And I am very pleased that the SEC has received assistance from an expanding list of countries in FCPA cases filed this fiscal year."

Chair Mary Jo White
U.S. Securities and
Exchange Commission
Washington, DC
September 21, 2016

Securities Regulation
in the Interconnected,
Global Marketplace

- According to the SEC, a UK-headquartered pharmaceutical company violated the internal controls and recordkeeping provisions of the FCPA.** These alleged violations occurred at the company's China-based subsidiary and China-based joint venture over the span of three years. It is alleged that employees of the company's subsidiary and joint venture engaged in various transactions and schemes to provide things of value to foreign officials and healthcare professionals. The SEC also states that collusive third parties were involved in the alleged misconduct, providing travel and other services to healthcare professionals and foreign officials. According to the SEC, the goal of the alleged payments and provisions was to gain influence over these officials and professionals to further sales for the company. The funds were obtained by allegedly disguising them as legitimate expenses and other payments in the company's books and records. According to the SEC, the company maintained neither sufficient internal accounting controls nor an effective anti-corruption compliance program which could have detected and/or prevented this type of misconduct. It is alleged that other instances of misconduct in the company's sales operations in other countries occurred as a result of these internal control and compliance-related deficiencies as well. The settlement of these allegations did not require the company to admit to any wrongdoing, but it did require them to pay a \$20 million civil penalty.
- The SEC cited a Chilean airline company with violations of the FCPA.** The alleged violations stem from payments approved by the chief executive officer. The claim states that \$1.2 million in payments were authorized to a consultant in connection with the airline's attempts to settle disputes on wages and other work conditions with the unions. At the time that the approval was granted, the SEC claims the chief executive officer was aware that the consultant would possibly pass some portion of the money to Argentinian union officials. According to the SEC, payments were made by the airline to a company controlled by the consultant and also to a company controlled by the consultant's son and wife. The claim alleges that following the completion of these payments, the consultant, acting on behalf of the airline, was able to negotiate settlements to the aforementioned disputes. The SEC further states that the airline had neither controls nor policies requiring due diligence to be performed on third parties with whom they contracted to do business. This lack of due diligence allegedly enabled the appointment of the consultant without the airline learning about his prior cabinet position within the Argentinean government. In addition to charges of FCPA violations, the airline was also cited for several violations of the Exchange Act related to inaccurate books and records and lack of internal accounting controls. The respondent's settlement involved an admission to the commission's findings and total monetary penalties in excess of \$22 million including a criminal penalty of \$12.8 million.
- The SEC accepted an offer of settlement from an energy company related to its violations of the books and records and internal control provisions of the FCPA.** Over a period of approximately three years, the company's Mexico-based subsidiary allegedly made improper payments to a contract employee at a Mexican state-owned oil company. The SEC claimed the goal of the payment was to induce the contract employee to provide inside information about the oil company to the respondent company. In addition, the respondent company allegedly sought advice and assistance on contracts with the oil company, as well as amplifications and amendments on those contracts. Per the SEC, the funds were transferred using an entity that professed to provide consulting services to the company, despite lack of authorization or evidence that any consulting relationship ever existed. The fund transfers were recorded as legitimate business expenses in the subsidiary's books and records, which were then consolidated into the company's books and records. The company allegedly lacked an effective internal control structure and also failed to respond to indications that its Mexican subsidiary was using consultants improperly. This settlement did not require the company to admit any wrongdoing, but it did require a disgorgement payment in the amount of \$5 million.

"We are often alerted to FCPA violations by companies self-reporting violations. The program has vastly increased the incentives for companies to self-report misconduct to us, as companies are aware that we may receive information from other sources if they are not forthcoming with us, and as I have emphasized before, if we learn the company made the decision not to self-report after learning of misconduct, there will be consequences."

Andrew Ceresney
Director of the SEC's
Division of Enforcement
Washington, DC
September 14, 2016

The SEC's Whistleblower Program:
The Successful Early Years

Violations of Books and Records

This quarter we categorized three AAERs 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. These three releases combined to result in \$2.4 million in civil penalties as part of settlements with the United States Department of Justice. Examples of this quarter's releases are as follows:

- The SEC cited a bank holding company and one of its two wholly-owned subsidiaries for improperly accounting for impaired loans.** According to the release, the company's accounting policies around its allowance for loan losses were not in compliance with GAAP. This allegedly impacted almost two years of the company's financial statements. According to the SEC, the company improperly included cash flows anticipated from guarantors into certain impairment analyses that it performed. The cash flows were allegedly included in these analyses despite the fact that the company was in active litigation with most of the guarantors at the time and collection of the amounts due was not expected. According to the SEC, the company also used collateral valuations provided by an outside contractor who was not an appraiser. The SEC further claimed that the company had no knowledge of the valuation methodology used by the contractor and was apparently was not presented with any documentation to support the valuations. According to the release, the calculated values were, more often than not, materially higher than those obtained from professional appraisers. This caused an understatement in the company's allowance for loan losses, and to correct the error, necessitated a restatement of almost two years of financial statements. Changes in the restated financial statements apparently included a \$22 million increase in the company's provision for loan losses and a 25% decrease in income before taxes for the first fiscal year and adjustments for another three quarters.
- The SEC entered into a settlement with a telecommunications company based in Portugal related to misleading and inaccurate disclosures for its investment in debt instruments and commercial paper.** According to the SEC, the debt instrument and commercial paper investments in question were issued by two entities of a Portuguese conglomerate. A third entity of the same conglomerate was apparently one of the company's largest shareholders. The SEC states that the company included an investment in commercial paper as part of the operating assets that it contributed to a Brazilian company during a merger. Approximately two months after the merger was complete, the company disclosed, apparently for the first time, that its operating assets included the commercial paper investment. According to the release, the issuer of the commercial paper defaulted on the debt within a month of the aforementioned disclosure apparently resulting in a renegotiation of the terms of the merger between the two parties. The Commission alleges that the company misrepresented the nature of the short-term investments in its financial statements and also failed to disclose the nature and extent of the credit risk to which it was exposed during the same time period. The Commission also charged the company with having insufficient internal accounting controls in place at the time. The settlement did not require the company to admit to the Commission's findings.
- The SEC charged a holding company with three insurance company subsidiaries with violations of the reporting, internal accounting controls, and books-and-records provisions of federal securities laws.** According to the SEC, the company announced that three years of its audited financial statements could no longer be relied upon and would be restated. During the restatement process, the company discovered dozens of additional errors including errors in calculations, assumptions, and application of accounting guidance. In some cases, the discovered

“Maintaining adequate internal accounting controls, representing annually to investors whether internal control over financial reporting (“ICFR”) is effective, and, when required, having an independent accountant attest to the effectiveness of ICFR, promotes reliable financial reporting and encourages investment in our capital markets. Over the next several years, updating and maintaining internal controls will be particularly important as companies work through the implementation of the significant new accounting standards...”

Wesley R. Bricker
SEC Interim Chief Accountant
Washington, DC
September 22, 2016

Testimony on Examining the
Agenda of Regulators, SROs, and
Standards-Setters for Accounting,
Auditing, and Municipal Securities

errors were due to improper accounting determinations and other errors appeared to highlight carelessness in the implementation of the company's accounting systems. According to the release, the company's restated Form 10-K identified errors in the areas of accounting for certain insurance and annuity product offerings, loss recognition, and valuation of annuities and derivatives. During the restatement process, the company also identified weaknesses in the company's internal controls over financial reporting.

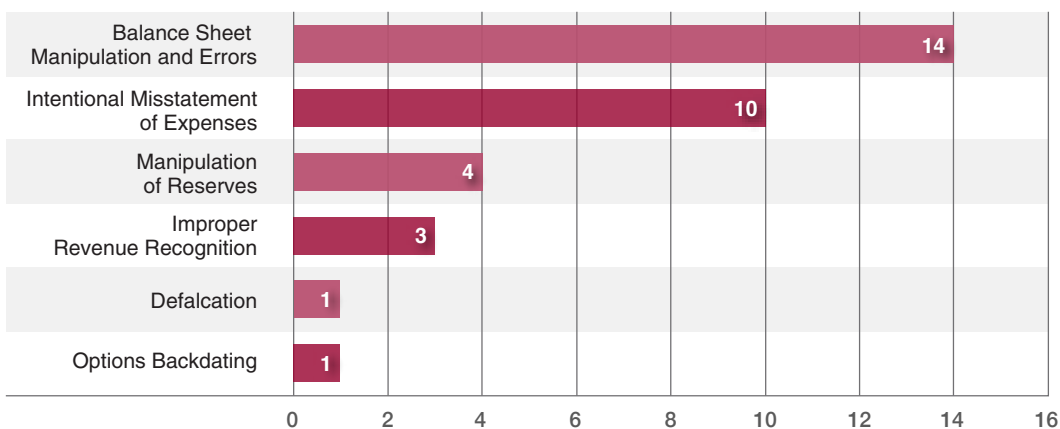
The Q3 2016 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in Q3 2016 AAERs, we identified the accounting problem(s) in each AAER based on the classification definitions below:

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

The chart below page illustrates the frequency of financial reporting issues by category among all AAERs issued during Q3 2016. Balance Sheet Manipulation and Errors remains the top category for the seventh straight quarter. Notably, many enforcement actions with incidents of wrongdoing related to revenue recognition, reserve accounting, and expense misstatement also impact company balance sheets and are classified comprehensively.

Financial Reporting Issues Identified in 2016 Q3 AAERs



“Companies’ implementation activities will require careful planning and execution, as well as sound judgment from management. And while internal controls cannot replace the need for sound professional judgment, well-designed, effective controls support the process by which those judgments are made and provide assurance that users of public companies’ financial statements are consistently provided with relevant and reliable information reported in accordance with the applicable financial reporting framework.”

Wesley R. Bricker
SEC Interim Chief Accountant
Washington, DC
September 22, 2016

Testimony on Examining the
Agenda of Regulators, SROs, and
Standards-Setters for Accounting,
Auditing, and Municipal Securities

Notable Q3 2016 AAERs 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.

For this quarter, we selected three AAERs to highlight. The first two releases involve the first SEC enforcement actions for auditor independence failures due to what the SEC described as “close personal relationships”. The third AAER summarized below provides details regarding the reinstatement of the Dell, Inc., former CFO who received a Rule 102 (e) suspension in 2010, and several interesting statistics about the population of recently reinstated individuals compared to those receiving Rule 102 (e) suspensions.

Accounting and Auditing Enforcement Release No. 3802 / September 19, 2016, Administrative Proceeding File No. 3-17552, In the Matter of Ernst & Young LLP and Gregory S. Bednar, CPA, Respondents.

Accounting and Auditing Enforcement Release No. 3803 / September 19, 2016, Administrative Proceeding File No. 3-17553, In the Matter of Ernst & Young LLP, Robert Brehl, CPA, Pamela J. Hartford, CPA and Michael T. Kamienski, CPA, Respondents.

While they address two entirely separate enforcement actions, these two releases issued on the same day offer noteworthy lessons for companies, audit committees and auditors regarding the importance of maintaining the independence of the auditor relationship, including the need for controls to ensure lines are not crossed.

In the first release, the SEC alleged that the senior partner on an engagement team for the audit of a New York-based public company maintained an improperly close friendship with its chief financial officer. In the second release, the SEC alleged that the audit partner for another public company was romantically involved with its chief accounting officer.

According to the first release, the relationship between the audit partner and the CFO included entertainment at golf and sporting events, family vacations and other indicia of a close friendship which caused auditor independence rule violations at Ernst & Young from January 2012 to March 2015. The audit partner and the CFO stayed overnight at each other’s homes on multiple occasions and traveled together with family members on overnight trips with no valid business purpose, and they exchanged hundreds of personal text messages, emails, and voicemails during the auditing periods. The audit partner also became friends with the CFO’s son and often treated the CFO and his son to sporting events and other gifts. Of concern to the SEC, certain Ernst & Young partners became aware of the audit partner’s excessive entertainment spending but took no action to confirm that the partner was complying with his independence obligations.

Ernst & Young agreed to pay \$4.975 million in monetary sanctions for these violations. The audit partner, who no longer works for the firm, agreed to a \$45,000 penalty and a rule 102 (e) suspension from appearing and practicing before the SEC as an accountant, which includes not participating in the financial reporting or audits of public companies.

“As long as management, and not the auditor, makes the final determination based upon its own analysis as to the accounting used, including determination of estimates and assumptions, and the auditor does not design or implement accounting policies, such auditor involvement as an input to management’s process can be appropriate. Further, timely dialogue between management and the auditor may positively impact audit quality and the quality of financial reporting.”

Wesley R. Bricker
SEC Interim Chief Accountant
Washington, DC
September 21, 2016

Remarks before the AICPA
National Conference on
Banks & Savings Institutions

In the second release, the SEC alleged that an audit partner caused auditor independence rule violations at Ernst & Young from March 2012 to June 2014, as a result of a romantic relationship with the CAO for her audit client. Similar to the allegations that others at the firm knew of the first partner's excessive entertainment spending, another Ernst & Young partner who supervised the audit partner on this client became aware of facts suggesting the improper relationship yet failed to perform a reasonable inquiry or raise concerns internally to Ernst & Young's U.S. independence group. Neither the audit partner nor the supervising partner remains at the firm.

According to the release, Ernst & Young required audit engagement teams to follow certain procedures to assess their independence, and employees were asked whether they had familial, employment, or financial relationships with audit clients that could raise independence concerns. However, the firm did not inquire of or assess the existence of non-familial close personal relationships that could impair the firm's independence. The firm agreed to pay \$4.366 million in monetary sanctions for these violations, and the audit partner and supervising partner agreed to pay penalties of \$25,000 each, and both accepted Rule 102 (e) suspensions.

Per the PCAOB audit standards, independence is defined as being without bias with respect to the client in order to ensure impartiality necessary for the dependability of findings regardless of technical proficiency. Of note, AICPA rule 1.120.010. states that client entertainment must be reasonable in the circumstances at the evaluation of the auditor, thereby leaving a fair level of judgment in assessing what may or may not be allowable.

In contrast, the rules from the PCAOB related to client gifts and entertainment of auditors are more restrictive and require prevent auditors from accepting anything more than a token gift.

These two enforcement actions provide valuable lessons for both public accounting firms as well as companies (and their audit committees) about the importance of developing and maintaining controls designed to identify and prevent circumstances that could impair auditor independence. As noted above, the company in the second release related to the romantic relationship had to undergo a re-audit of the impacted years, which is a costly and precarious process that a company would want to avoid. While a company's outside auditor certainly has a professional duty to maintain its independence, companies with strong and effective policies and controls related to social activities between company and key outside constituents - including audit team personnel - would stand a better chance of avoiding such a situation without having to rely solely on its auditor to detect such circumstances.

"These are the first SEC enforcement actions for auditor independence failures due to close personal relationships between auditors and client personnel," said Andrew J. Ceresney, Director of the SEC's Division of Enforcement.

Accounting and Auditing Enforcement Release No. 3791 / July 22, 2016, Administrative Proceeding File No. 3-14171, In the Matter of James M. Schneider, CPA.

The SEC reinstated James M. Schneider, CPA, the former Chief Financial Officer of Dell, Inc. Mr. Schneider is now able to appear and practice before the Commission, subject to certain ongoing restrictions. Mr. Schneider had accepted a Rule 102 (e) suspension from appearing or practicing before the SEC as an accountant on December 22, 2010 related to allegations made by the SEC that he made - or was involved in making - material misrepresentations in earnings calls, and material misrepresentations and omissions in Dell's quarterly and annual reports on Forms 10-K & 10-Q for the fiscal years 2003 through approximately 2006. The allegations involved the accounting treatment and the impact on Dell's operating results of payments received from Intel Corp.

"Independent auditors have been long-recognized as one of the key gatekeepers in our investor protection system, and the integrity of this system is supported by the PCAOB's oversight of the public company auditors. The credibility of public company financial reporting depends, in part, on thorough and objective audits performed by independent auditors."

Wesley R. Bricker
SEC Interim Chief Accountant
Washington, DC
September 22, 2016

Testimony on Examining the
Agenda of Regulators, SROs, and
Standards-Setters for Accounting,
Auditing, and Municipal Securities

According to the release, Mr. Schneider will be allowed to serve as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission. In fulfilling these duties, Mr. Schneider attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity.

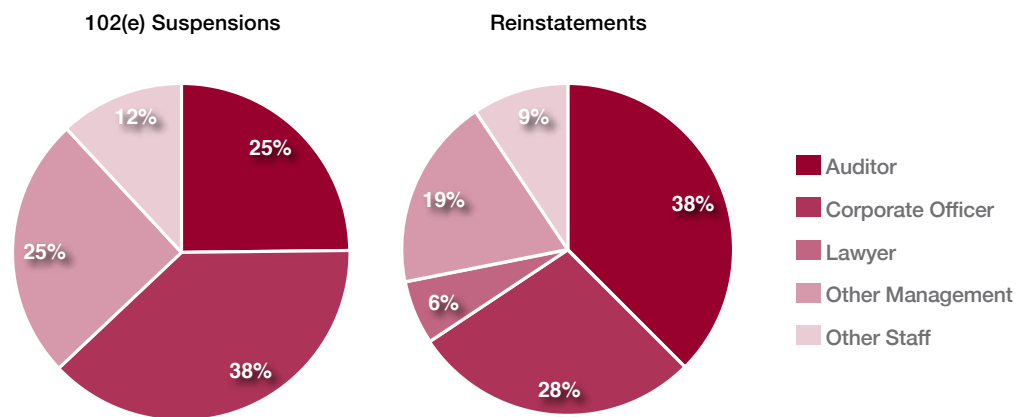
In addition Mr. Schneider may serve on an audit committee, albeit subject to certain limitations including Schneider that he will undertake to (i) have any action taken as a member of the audit committee subject to the scrutiny of the full audit committee, with no function or responsibility independent of the audit committee as a whole; (ii) not accept any delegation of authority to act on behalf of the chair of the audit committee or the audit committee as a whole; and (iii) not serve as chair of an audit committee, absent review and approval by the Office of the Chief Accountant that in carrying out his duties as chair, Mr. Schneider will continue to comply with the requirement that he have his work reviewed by the independent audit committee as a whole or in some other acceptable manner.

Schneider did not seek reinstatement to appear or practice before the Commission as an independent accountant. Therefore, he is not allowed to serve in such capacity. Rule 102(e)(5) of the SEC’s Rules of Practice governs applications for reinstatement, and provides that the SEC may reinstate the privilege to appear and practice before the Commission “for good cause shown”, a determination that is highly fact specific and subject to judgment by the SEC. While releases are available for those reinstated, there is not similar data available for who applies for reinstatement.

We compared all publicly disclosed Rule 102 (e) suspensions for the five years ended September 30, 2016, to all disclosed reinstatements for the same period. Over that five-year period, there was a total of 286 disclosed suspensions and 32 disclosed reinstatements. We made several observations, as illustrated in the following charts and as discussed further below.

Corporate Officers Are Issued the Most 102(e) Suspensions, Auditors Are Issued the Most Reinstatements

Q1 2011 through Q3 2016



102(e) suspensions issued and reinstatements issued are not consistent between the two largest categories of professionals; corporate officers and auditors. Between 2011 and 2016, 38% of all 102(e) suspensions issued were to corporate officers, while only 25% were issued to auditors. The opposite is found when examining reinstatements spanning that same time period; only 28% of all reinstatements were issued to corporate officers, while 38% of all reinstatements were issued to auditors.

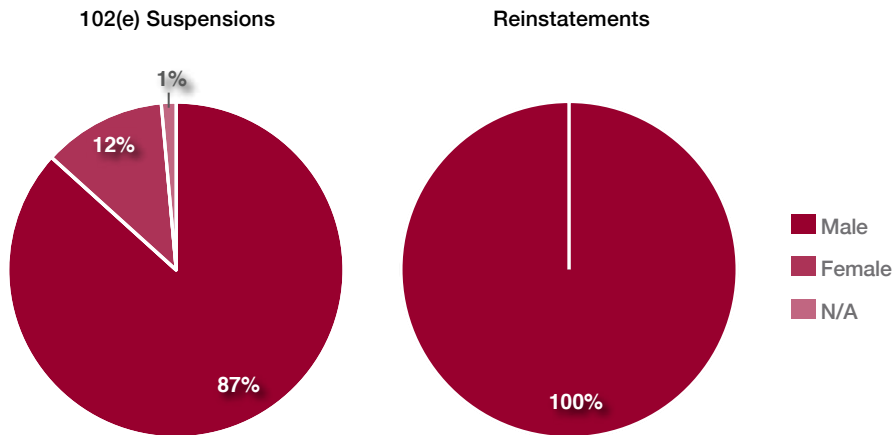
“Recent PCAOB inspection results show promising signs of improvement in many audit firms’ quality controls that are designed to ensure compliance with professional auditing standards as determined by the PCAOB. And while those improvements are not uniform across all firms or necessarily consistent within individual firms, and there is more work to be done, these findings do reflect the progress that has been achieved in improving audit quality since the passage of the Sarbanes-Oxley Act and the creation of the PCAOB.”

Wesley R. Bricker
SEC Interim Chief Accountant
Washington, DC
September 22, 2016

Testimony on Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and Municipal Securities

No Reinstatements Were Issued to Women

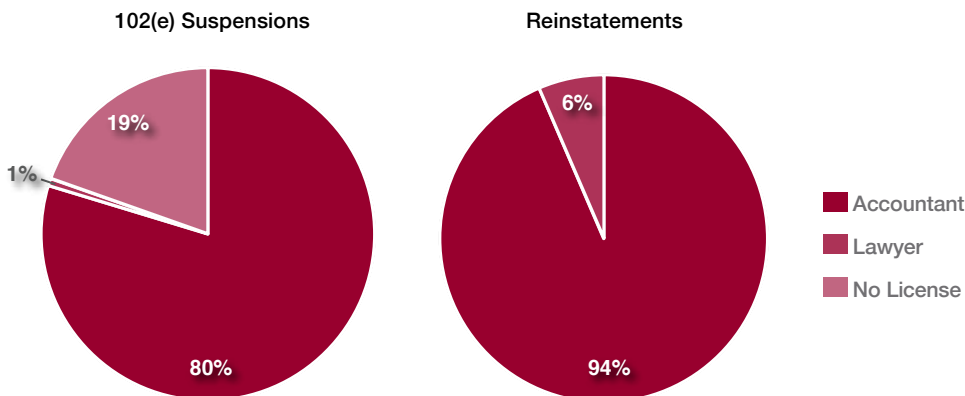
Q1 2011 through Q3 2016



A vast majority of 102(e) suspensions were issued to men; 87% of the total between 2011 and 2016 to men as opposed to 12% to women. With regard to reinstatements, none were issued to women between 2011 and 2016. 100% of the 32 reinstatements issued during that time period were to men.

Accountants are Subjected to the Vast Majority of 102(e) Suspensions and Reinstatements

Q1 2011 through Q3 2016



Accountants are, by far, the most common professional designation to receive 102(e) suspensions. 80% of the 102(e) suspensions handed out between 2011 and 2016 were issued to individuals who held some type of accounting certification. This group is almost entirely made up of CPAs, but it also includes several chartered accountants who hold certifications from a variety of international accounting boards. It's worth noting that roughly one-fifth of the 102(e) suspensions issued were to individuals who did not hold professional licenses. With regard to reinstatements, a higher percentage of reinstatements issued between 2011 and 2016 were to accountants. Interestingly enough, no reinstatements were issued to individuals who held no professional licenses during that time period.

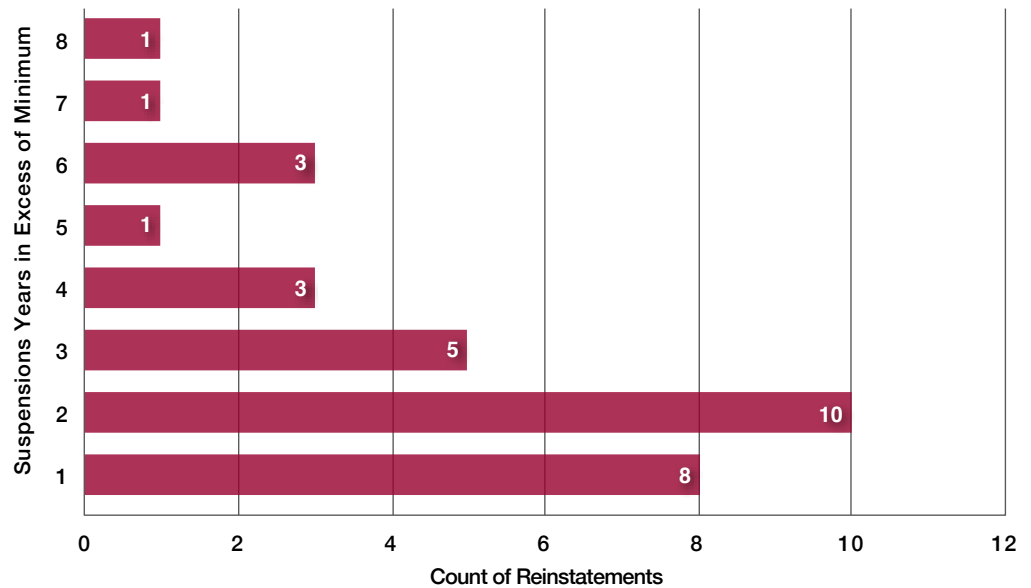
“The Commission’s cases against auditors generally fall into two categories — audit failures and auditor independence violations. Generally, an audit failure occurs when an auditor deviates from the applicable professional standards in such a way that indicates the opinion contained in its audit report is false. As for independence, an auditor must be independent of its SEC audit clients pursuant to SEC and PCAOB rules, both in appearance and in fact.”

Andrew Ceresney
 Director of the SEC’s
 Division of Enforcement
 Washington, DC
 September 22, 2016

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Years of Suspension Served Beyond Required Minimum Suspension Before Reinstatement

Q1 2011 through Q3 2016



Also worth noting is that most reinstatements are issued in the first two years following the expiration of an individual’s required suspension term. The chart above reflects the time in years elapsed between the end of an individual’s minimum required suspension term and their reinstatement. Of the thirty-two total reinstatements that have been issued between 2011 and 2016, eighteen of them have occurred within the first two years following the expiration of an individual’s minimum required suspension term.

“In some instances, auditors will be charged based on misrepresentations in their audit report. And, when an auditor of an issuer determines it is likely that an illegal act has occurred, the federal securities laws require the auditor to investigate and report upwards pursuant to Section 10A of the Exchange Act. Failure to do so can also be the basis for Commission action.”

Prior Period Comparisons: Year over Year and Quarterly Statistics

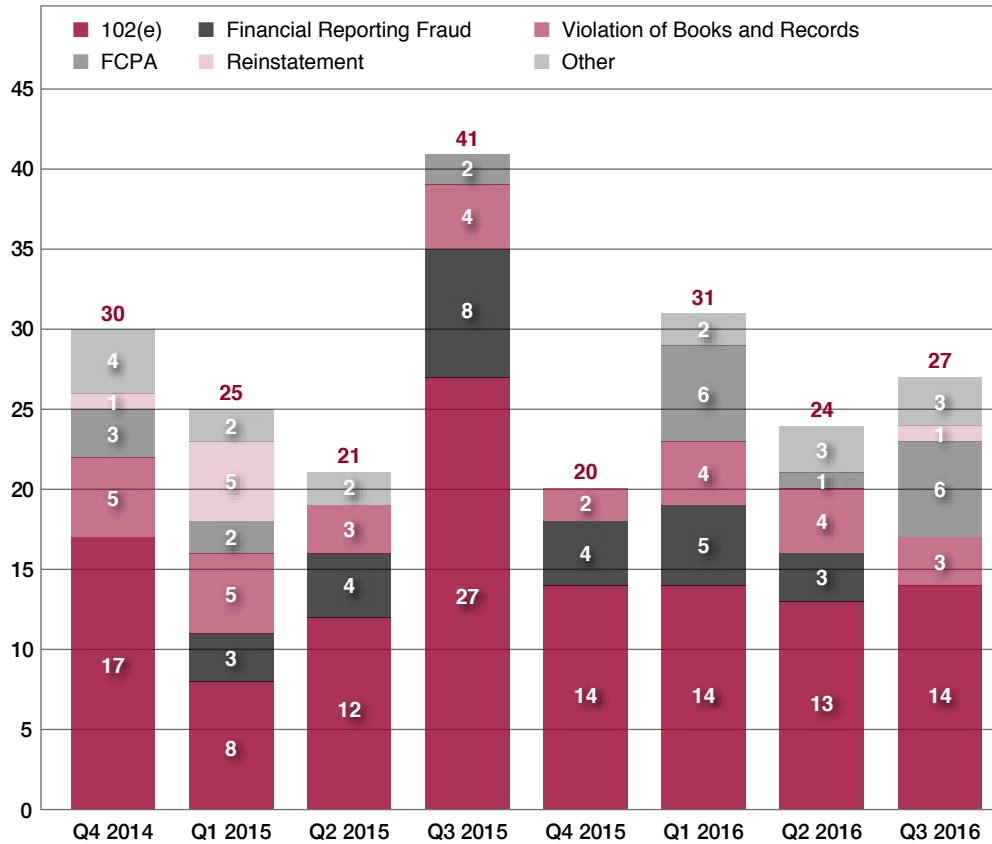
As described in the section titled “Our Process and Methodology,” AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all of the actions that may fit into the definition the SEC provides for the classification. That said, comparisons of the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

Andrew Ceresney
 Director of the SEC’s
 Division of Enforcement
 Washington, DC
 September 22, 2016

The SEC Enforcement Division’s
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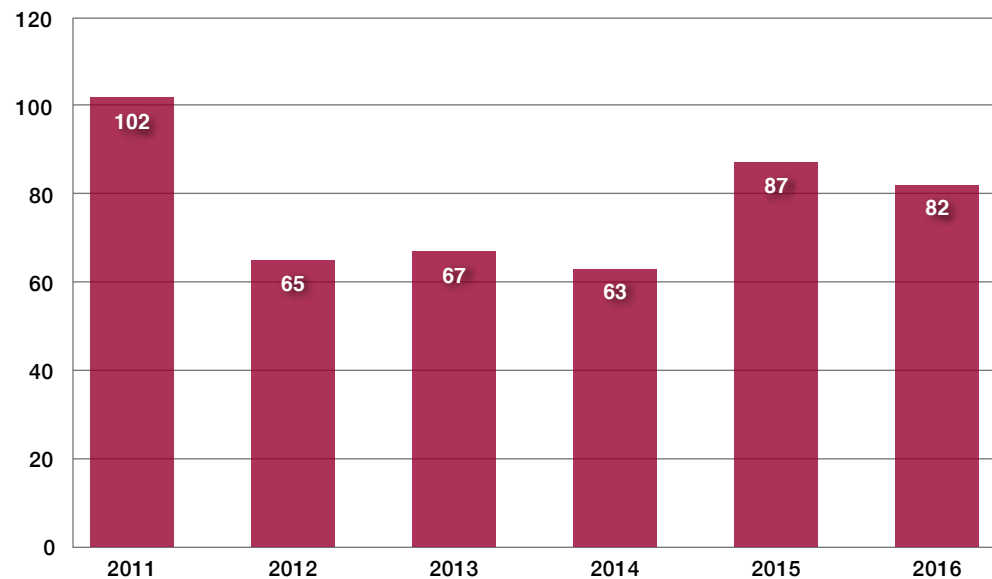
Quarter to Quarter AAER Comparison for the Last Eight Quarters

Q4 2014 through Q3 2016



Q1-Q3 AAER Volume for the First Nine Months of Each Year

For the Period January 1 - September 30



“Rule 102(e) is not the only tool available to the Commission. For example, the Commission can charge auditors with direct violations of the securities laws, including charging them with primary violations of the anti-fraud provisions of the securities laws in those somewhat rare situations where auditors are engaged in fraud, or secondary violations where they aided and abetted or caused primary violations by others.”

Andrew Ceresney
 Director of the SEC's
 Division of Enforcement
 Washington, DC
 September 22, 2016

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ACKNOWLEDGEMENT

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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, and Transaction Analysis.

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