Floyd Advisory

Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended September 30, 2014

Q3 REPORT 2014

CONTENTS

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, 2014.

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 2014

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, 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.

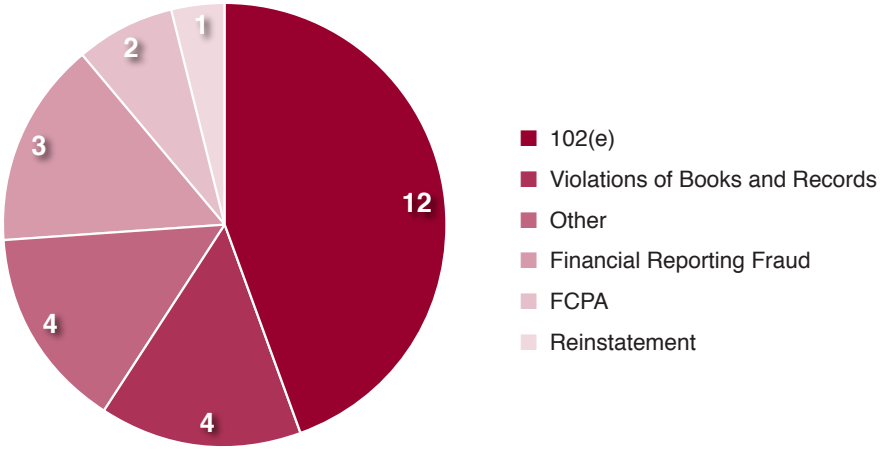
REVIEW PROCESS

- 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 2014 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed 26 AAERs during Q3 2014 which we have sorted into the following categories as shown in the pie chart.

Q3 2014 AAERs by Category



SEC disclosed AAERs for the Quarter Ended September 30, 2014:

26

While the categorical breakdown is analytically useful, a closer look into each category provides a clearer understanding of the SEC's actions.

Rule 102(e) Actions

As reflected in the chart, Rule 102(e) actions accounted for almost half of the releases issued in Q3 2014. Notably, five out of twelve actions were brought against auditors or audit firms. In addition, out of the total number of individuals receiving the sanction, 11 were certified public accountants.

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.

Examples of the types of actions reported in this quarter's Rule 102(e) releases are as follows:

- ***The SEC charged an audit firm with violations of certain independence rules with respect to two audit clients.*** The firm offers auditing, consulting, and tax services and was also providing certain legislative advisory services to its audit clients. In one example, members of the firm's legislative advisory service division allegedly sent letters urging passage of bills to congressional staff on behalf of its Client A, which were crucial to the client's business interests. In another case, according to the SEC, the firm's advisory division personnel asked congressional staff to insert into a bill a provision favorable to Client A. Additionally, the SEC alleged that for audit Client B, the firm attempted to persuade congressional offices to withdraw their support for legislation detrimental to that client's business interests. The firm allegedly worked closely with congressional staff in drafting an alternative bill more favorable to its audit Client B. The SEC stated that members of the legislative advisory services group also marked up a draft of the alternative bill, inserting specific language written by Client B, and sent the mark-up to congressional staff. Nevertheless, per the release, the firm continually represented that it was "independent" in audit reports issued on Client A's and Client B's financial statements, which were included or incorporated in public filings with the SEC. The SEC imposed a cease and desist order from committing or causing any violations and any future violations and ordered the firm to pay a penalty, a disgorgement, and a prejudgment interest after considering firm's cooperation with the SEC.

- ***The SEC alleged improper professional conduct by a public accounting firm that was registered with the PCAOB and performed audits for several clients in China and its former partner that led the firm's practice.*** The individual was an audit engagement partner of a client, headquartered in the People's Republic of China, which became an issuer through a reverse merger in 2006. The company claimed to sell airline tickets, hotel rooms, and packaged tours by telephone, in person, and over the internet. The SEC settled an injunctive action against the company and its former chief executive officer and chief financial officer in September 2013, alleging financial reporting fraud as well as books and records and internal controls violations.

  The public accounting firm became the company's auditor in 2011. The SEC alleged that the firm failed to make inquiries of the predecessor auditor of the company before accepting this engagement, thereby preventing them from discovering several audit issues the auditor was encountering. The firm allegedly failed to establish adequate client acceptance policies that require an audit firm to obtain reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized. Approximately one year prior to the firm's acceptance of this client, an Australian advisory firm published a report raising suspicion about the company's operations. According to the release, the public accounting firm failed to adequately plan the audit, obtain sufficient and appropriate audit evidence, exercise due professional care, exercise professional skepticism, and control the confirmation process. Finally, the SEC alleged that the firm failed to adequately document accounts receivable testing and properly retain documentation.

COLLABORATION, COOPERATION AND OVERSIGHT

"...the decisions that we make have the potential to shape market structure and affect our national market system. Our markets and the investors and companies they serve are too important not to be constantly and deeply examined for how they can be improved and strengthened."

Chair Mary Jo White
U.S. Securities and Exchange Commission
2014 SRO Outreach Conference
Washington, D.C.
September 17, 2014

In addition to assessing a civil monetary penalty to the former audit partner and imposing various penalties on the audit firm, the SEC prohibited the firm from issuing any audit report and accepting "any audit engagement, or play[ing] a substantial role in the preparation or furnishing of any audit report for any issuer or registrant, U.S. or foreign, that files with the Commission and (i) has headquarters or principal executive offices located in the PRC, or (ii) has a subsidiary or component in the PRC the assets, revenues, or expenses of which constitute 20% or more of the consolidated assets, revenues, or expenses … of the registrant or issuer."

- ***Another AAER in this category related to a topic that made it to our Recommended Reading section in Q3 2013 and focused on the SEC's interpretation of Rule 102(e), where the individual asked the SEC to state that the order did not prohibit him "from accepting non-accountant positions, such as positions on an audit committee or as a non-accountant CFO."*** The SEC denied this request and provided explanation. Within the most recent AAER, the individual for a second time asks the SEC for "clarity" of the Rule 102(e) order that the previous order does not prevent him from serving on the audit committee of a public registrant.

  The release involved a certified public accountant and the former CEO of an electronics products and services company. In 2010, the SEC filed a civil enforcement action against the company, the former CEO, and other executives, charging them with fraud and various reporting and recordkeeping violations, subsequently suspending the former CEO from appearing or practicing as an accountant pursuant to Rule 102(e) with the right to apply for reinstatement after five years. In this second request, the individual specifically asks about a role as an audit committee member of a public registrant. The SEC stated that his new request suffers from the same flaw as his first: asking for a declaration that his service on an audit committee will not constitute "appearing or practicing before the Commission as an accountant" based on only the title and other broad generalities about the position, rather than the actual conduct that the individual might perform when serving in that role.

COLLABORATION, COOPERATION AND OVERSIGHT

"While we know that perfection is not possible, it must always be the goal. We need to have zero tolerance for systems issues that undermine the reliability of our markets and erode investor confidence."

Chair Mary Jo White
U.S. Securities and Exchange Commission
2014 SRO Outreach Conference
Washington, D.C.
September 17, 2014

Violations of Books and Records

We categorized four AAERs under Violations of Books and Records this quarter, 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. One of the releases is worth detailed discussion and is described in our Recommended Reading section, while several others are described below:

- ***A former CEO and Chairman ("former CEO") of a reseller of used computer equipment and a maintenance services provider, allegedly had knowledge of various deficiencies in the company's system of internal controls for inventory that resulted in the falsification of its books and records.***

According to the complaint, every now and then, in 2008 and more frequently in 2009, the former CEO improperly accelerated the recognition of accounts receivable and receipt of inventory on company books and records with the interest of increasing the borrowing base available under a revolving credit facility with the company's chief creditor. The SEC stated that this information was also withheld from the company's external auditors throughout their audit of financial statements for the fiscal year ended December 31, 2008 and their review of the financial statements for the quarter ended March 31, 2009. Further, the former CEO signed a Form 10-K and a Form 10-K/A for the 2008 fiscal year, each containing a management's report on internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002 and Exchange Act Rule 13a-15(c), which falsely represented that he, in his capacity as CEO, had participated in assessing the effectiveness of the company's internal controls. He also signed certifications required under Section 302 of the Sarbanes-Oxley Act and Rule 13a-14 of the Exchange Act included in filings with the SEC falsely representing that he had evaluated the company's internal controls over financial reporting and, based on this evaluation, disclosed all significant deficiencies to the auditors. As a result, the SEC issued a cease and desist order against the individual from committing or causing any future violations of the Exchange Act.

- ***The SEC alleged that a software solutions company materially misstated its revenue, net income and other financial information in its annual and quarterly reports during the period from 2008 until 2011.*** Notably, the company allegedly failed to properly record and report revenue from its software license sales in the correct accounting periods because it did not establish vendor specific objective evidence of fair value, required by GAAP, for certain services and consulting arrangements it sold in a bundle with its software licenses. Furthermore, the SEC stated that the company failed to properly record and report revenues from the sale of software licenses and certain services agreements that were tied to each other. The company's alleged misrepresentations were due to inadequate internal control policies and procedures established within revenue recognition, identified as a high risk area. Consequently, the company restated its financial results and also acknowledged the presence of material weaknesses in its internal controls over financial reporting. According to the SEC, the company violated the reporting, books and records, and internal controls provisions of the federal securities laws.

Other

Four AAERs were placed in the "Other" category, two of which are an addition to a number of AAERs that focus on one significant issue involving several foreign public accounting firms based in the People's Republic of China and their alleged willful refusal to provide the SEC with audit work papers, a violation of the Sarbanes-Oxley Act. We have already highlighted some of these AAERs in our reports for the previous quarters. Another AAER in this category worth highlighting is summarized on the following page.

WHATEVER HAPPENED TO PROMOTING SMALL BUSINESS CAPITAL FORMATION?

"The SEC should be focused on personal responsibility for individual wrongdoers rather than corporate liability and shareholder penalties for amorphous misconduct. Similarly, we should ensure that we recognize that not every business failure is fraudulent. Entrepreneurs need to have the room to take risks, which means room to fail. Without risk there is no reward for investors."

Commissioner Daniel M. Gallagher
U.S. Securities and Exchange Commission
Washington, D.C.
September 17, 2014

- ***According to the release, a registered broker-dealer that is required to submit its annual reports to the SEC, traded stock of a company that audited its financial statements, therefore impairing its independence.*** The public accounting firm is associated with a publicly traded company through a business model referred to as an alternative practice structure, a model that utilizes an administrative service agreement which requires the public accounting firm to lease from the publicly traded firm virtually all of the human capital, equipment, and overhead required to perform its attest work, in exchange for a majority of its revenue. Notably, according to the SEC, the two companies are viewed as a single entity for auditor independence evaluation purposes and as a result, the audits do not comply with the SEC financial reporting rules for those periods. The SEC initiated enforcement actions against both the broker-dealer and the public accounting firm, with the firm also receiving a 102(e) sanction and a civil monetary penalty.

Financial Reporting Frauds

There were three AAERs that we categorized as Financial Reporting Frauds during the quarter. Two of them arose from same event, which we describe below:

There were three AAERs that we categorized as Financial Reporting Frauds during Q3 2014.

- ***A Silicon Valley-based enterprise software company, which was delisted from trading on NASDAQ in April 2013 for delinquent SEC filings, was allegedly involved in a fraudulent revenue reporting scheme based on falsifying time records for certain professional services.*** The wrongdoing was allegedly carried out from 2007 through 2012 by professional services managers throughout the organization who directed consultants in an Indian subsidiary to fabricate time records by either recording time in advance of performance of work, or failing to record time for hours worked in order to achieve their quarterly revenue and margin targets. The SEC placed blame on the former CEO of the company and its two former vice presidents, who were the most senior individuals involved in the fraudulent time-reporting practices and understood the impact of these improper practices on the company's financial reporting.

  Over the relevant period, the company cumulatively overstated the company's reported pre-tax earnings by approximately $70 million and made material misstatements regarding its revenue recognition practices. In addition, the SEC alleged that the time-reporting misconduct went undetected and uncorrected for so long because the company failed to devise and maintain adequate internal accounting controls over its professional services business.

  As the result of the misconduct, all of the individuals were ordered to pay disgorgement, civil penalties, and prejudgment interest. In addition, the former CEO was ordered to pay a large sum back to the company based on prior bonuses received, other incentive-based or equity-based compensation, and profits on sale of company's stock.

FCPA Violations

There were two FCPA-related releases in Q3 2014, one of which is a settlement action with the former officers of an offshore drilling services provider. An additional release involved violations that took place from 2007 through early 2010, involving a senior employee and other employees and representatives of a company that allegedly made, authorized, and offered to make improper payments and provide gifts to foreign officials in an attempt to win contracts to sell firearm products to foreign military and law enforcement departments. Key facts in the releases are as follows:

- ***We first introduced this case in our Q1 2012 report, wherein the SEC charged three executives of a leading provider of diversified services for the oil and gas industry with FCPA violations.*** The individuals, a former CEO and a former director and divisional manager, who, according to the SEC, remains an executive at the company, agreed to settle civil actions against them after allegedly participating in a bribery scheme involving payments to retain business under lucrative drilling contracts for oil rigs in Nigeria.

  In its complaint in 2012, the SEC alleged that the former CEO and the former director authorized the payment of bribes to customs officials to process false paperwork purporting to show the export and re-import of oil rigs, when in fact the rigs never moved. The SEC alleged that the scheme was designed to save the company from losing business and incurring significant costs associated with exporting rigs from Nigeria and then re-importing them under new permits.

  The SEC also settled charges against a former controller and head of internal audit at the company. The SEC alleged that the individual helped approve the bribe payments and allowed the bribes to be booked improperly as operating expenses of the company.

- ***An additional FCPA AAER involved a senior employee and other employees and representatives of a global firearms manufacturing company.*** The individuals allegedly made, authorized and offered to make improper payments and provide gifts to foreign officials in an attempt to win contracts to sell firearm products to military and law enforcement departments overseas.

  According to the release, the company employees were attempting to expand the growth of its business in various international locations, which, at the time, comprised approximately 10% of the total revenue. Allegedly, bribes were then improperly recorded on the company's books and records and represented as sales commissions and other legitimate business expenses.

There were two FCPA related releases in Q3 2014, one of which is a settlement action with the former officers of an offshore drilling services provider. An additional release involved violations that took place from 2007 through early 2010, involving a senior employee and other employees and representatives of a company that allegedly made, authorized, and offered to make improper payments and provide gifts to foreign officials.

According to the SEC, the company did not have subsidiaries located overseas and operated through brokering agents. Allegedly, the company failed to design and implement a system of internal controls or an appropriate FCPA compliance program reasonably designed to address the increased risks of its business model and, as a result, violated anti-bribery laws as well as committed books and records violations, and failed to maintain sufficient internal controls. The company allegedly took immediate action to resolve all of the violations alleged by the SEC.

Reinstatement

During Q3 2014, the SEC reinstated one individual to appear and practice before the SEC as an accountant:

- ***A former controller of a company that produces and markets value-added, metal-based specialty chemicals and related materials was reinstated to appear and practice before the SEC as an accountant responsible for preparation and review of financial statements required to be filed with the SEC.*** The individual was suspended in 2007 for allegedly being part of fraudulent accounting practices that took place in 2001 and earlier.

  According to the release, the former controller recorded numerous erroneous and unsupported accounting entries in its books and records at the direction of its parent company's former CFO and former controller. These accounting practices allegedly included, among other things, recording inaccurate inventory estimates and recording erroneous journal entries related to certain litigation liabilities. In addition, the complaint alleges that the former controller, in part, failed to provide sufficient information to the company's independent auditor about the accounting entries and estimates.

AAERs reported by Financial Reporting Issue for Quarter Ended September 30, 2014:

19

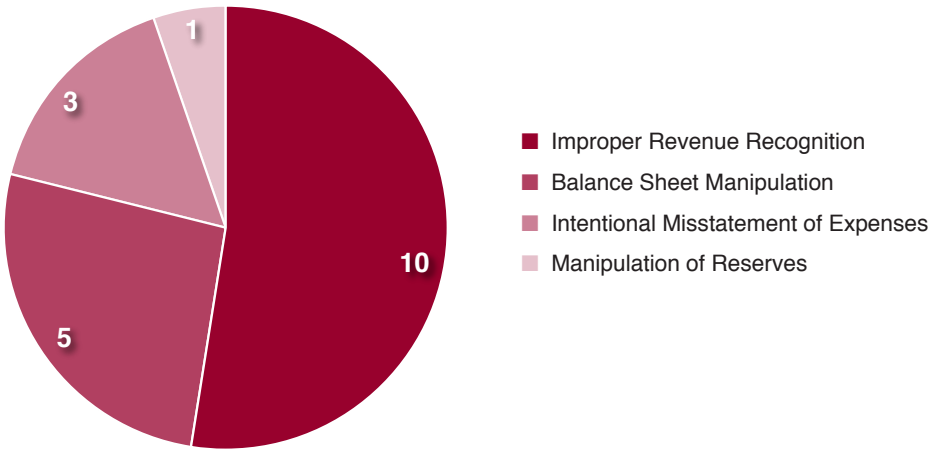
The Q3 2014 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in Q3 2014 AAERs, we identified the accounting problem(s) in each AAER based on the classification definitions on the next page:

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
Defalcation	Thefts of funds and assets

The following chart provides the results of our financial reporting issue analysis for the Q3 2014 AAERs.

Financial Reporting Issues Identified in Q3 AAERs



Improper Revenue Recognition is the leading category of accounting issues identified within AAERs this quarter, a trend we have not seen since Q4 2011. Recently, financial reporting issues around Balance Sheet Manipulation have led the charts most quarters. A significant number of Revenue Recognition enforcement actions are attributable to multiple associated AAERs, however, the exclusions of those particular AAERs would still result in Improper Revenue Recognition accounting issues taking the lead.

Improper Revenue Recognition is the leading category of accounting issues identified within AAERs this quarter, a trend we have not seen since Q4 2011.

Notable Q3 2014 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.

Below is an AAER related to actions brought by the SEC against former executives, highlighting the importance of and advantage to individuals who agree to cooperate during an SEC investigation. Next, our discussion focuses on sensitive issues that may arise when failing to recognize the substance of transactions when making revenue recognition accounting decisions.

The SEC favors cooperation by both corporations and individuals and has provided details on what cooperation means. This program provides incentives to individuals and companies who come forward and provide valuable information to the SEC.

Securities and Exchange Commission v. Volt Information Sciences, Inc. Litigation Release No. 23051, Accounting and Auditing Enforcement Release Nos. 3569 and 3570

The SEC announced that the Honorable William H. Pauley III, United States District Judge for the Southern District of New York, entered a final judgment in the SEC's civil action against the former CFO of Volt Information Sciences, Inc. ("Volt").

In making its announcement, the SEC stated that its litigation against the former CFO was assisted by cooperation from the former CFO of a Volt subsidiary ("the former subsidiary CFO"), an individual with whom the SEC also reached a settlement this quarter. Importantly, as a result of the former subsidiary CFO's cooperation, the SEC did not to seek a financial penalty against her individually. According to the SEC, the cooperating former subsidiary CFO did, however, accept a Rule 102(e) five year suspension for appearing or practicing before the SEC, without admitting or denying the SEC's allegations. The complaint stated that the former subsidiary CFO was a certified public accountant licensed to practice in the State of Virginia, but that license expired in 1988. She served as the subsidiary CFO from 1996 until 2008, when she became the subsidiary's COO, a position she held until she was terminated in 2012 as a results of Volt's financial reporting problems.

The SEC's complaint against these individuals alleged that for Volt's fiscal year ended October 28, 2007, Volt's computer segment subsidiary improperly recognized $7.55 million of revenue included in its financial statements filed with the SEC. Further, it is alleged that the improper recognition of this revenue caused Volt's net income for its fourth quarter and fiscal year ended October 28, 2007 to be materially and falsely overstated. The complaint specifically detailed that the former subsidiary CFO justified the improper revenue recognition by asserting the existence of, and the subsidiary's substantial performance on, a $10 million customer contract, even though the purported contract did not lead to an event recognizable as revenue under generally accepted accounting principles.

Allegedly, the company's recognition of revenue relied on a fabricated software contract with a customer. Notably, according to the complaint, the former CFO knew that any sale of the software was impossible because Volt intended to lease the same software to the same customer the following year. Nevertheless, the CFO allegedly authorized that the $7.55 million in improper revenue be included in the company's consolidated income statement for 2007. The CFO signed the allegedly fraudulent 2007 Form 10-K and subsequent SEC filings that included the same overstatement of revenue. In addition, the complaint alleged that the CFO misled Volt's external auditors and signed one or more certifications required by Section 302 of the Sarbanes Oxley Act that were false and misleading.

The CFO accepted a suspension from appearing or practicing before the SEC as did the former subsidiary CFO, both without admitting or denying the SEC's allegations. The CFO, however, paid a financial penalty, a burden not imposed on the cooperating former subsidiary CFO. From the pleadings and AAERs, it's difficult to decipher specific differences in culpability and knowledge of the improper revenue recognition between the two former employees of Volt. Of note, the SEC made a point of highlighting that the former subsidiary CFO's cooperation against the CFO played a role in her lack of a financial penalty.

The SEC favors cooperation by both corporations and individuals and has provided details on what cooperation means. This program provides incentives to individuals and companies who come forward and provide valuable information to the SEC. The SEC uses an analytical framework to evaluate whether, how much, and in what manner it credits cooperation by individuals and companies in its investigations and enforcement actions. The benefits to cooperators range from reduced charges and sanctions in enforcement actions to no enforcement action at all.

The SEC uses an analytical framework to evaluate whether, how much, and in what manner it credits cooperation by individuals and companies in its investigations and enforcement actions.

In January 2010, the SEC issued a policy statement detailing a framework for evaluating cooperation by individuals in the SEC's investigations and actions. This policy statement identified four general considerations to use in assessing cooperation:

- *Assistance provided by the cooperator.* This includes considerations such as the value and nature of the cooperation;
- *Importance of the underlying matter.* This includes considerations such as the danger posed to investors by the underlying misconduct;
- *Interest in holding the individual accountable.* This includes considerations such as a cooperator's culpability relative to that of other violators; and
- *Profile of the individual.* This includes considerations such as acceptance of responsibility for the misconduct.

For additional information, see the *Policy Statement of the Securities and Exchange Commission Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions,* SEC Rel. No. 34-61340 (Jan. 13, 2010). Information concerning the circumstances under which individuals may receive credit as part of the SEC's cooperation initiative also is available in a litigation release, *SEC Credits Former AXA Rosenberg Executive for Substantial Cooperation during Investigation,* Lit. Rel. No. 22298 (March 19, 2012). For information on the benefits and considerations for the cooperation of corporations, see the *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions,* SEC Rel. Nos. 34-44969 and AAER-1470 (Oct. 23, 2001).

In the Matter of Lynn R. Blodgett and Kevin R. Kyser, CPA, Respondents. ACCOUNTING AND AUDITING ENFORCEMENT Release No. 3578

The accounting guidance related to assessing the substance of a transaction and whether or not gross revenue should be recognized is found in ASC 605-45-45, Other Presentation Matters.

The former CEO and CFO ("former officers") of Affiliated Computer Services, Inc. ("ACS") have submitted an offer of settlement, which was approved by the SEC and included a provision ordering the former officers to cease and desist from further violations of the securities laws and to pay disgorgement and other financial penalties related to improper revenue recognition accounting practices. Of note, the former officers did not receive Rule 102(e) suspensions from appearing or practicing before the SEC.

A reduced punishment is common in the case of unintentional error. However, Commissioner Luis A. Aguilar wrote in his dissenting statement that with regard to one of the former officers, "given the egregious conduct that Mr. Kyser engaged in at ACS, the Commission's settlement, which lacks fraud charges or a timeout in the form of a Rule 102(e) suspension, is a wrist slap at best."

ACS was a Delaware corporation headquartered in Dallas, Texas. ACS provided business process outsourcing and information technology services through two reportable operating segments: the Commercial Services Group, which accounted for approximately 60% of ACS's fiscal year 2009 revenues, and the Government Services Group, which accounted for the remaining 40% of ACS's revenues. Historically, ACS generated approximately 85% of its revenues from recurring, long-term contracts and 15% from non-recurring transactions. In its Form 10-K for the fiscal year ended June 30, 2008, ACS disclosed that its primary goal for fiscal year 2009 was to "increase internal revenue growth." In an August 7, 2008 analyst call, the CEO characterized ACS as "well positioned to accelerate internal revenue growth in fiscal year 2009." ACS merged in February 2010 with a subsidiary of Xerox Corporation, and the ACS corporate entity was subsequently dissolved.

According to the SEC, in an attempt to artificially increase revenue, ACS arranged for an equipment manufacturer to redirect, through ACS, approximately $20 million in preexisting orders that the manufacturer already had received from another reseller. According to the SEC, ACS's transaction documents for this arrangement gave the appearance that ACS was involved in "resale transactions," but ACS had no such involvement. Even after ACS was inserted into the "resale transactions," it is alleged that the pricing for equipment remained unchanged and the equipment continued

to be shipped from the manufacturer directly to the reseller's customers (i.e. ACS never had actual or constructive possession of it), and the reseller's customers were unaware that ACS was even involved. In short, these pre-existing orders between the manufacturer and another reseller proceeded in all material respects according to their original terms and were unaffected by ACS.

ACS and the manufacturer executed virtually identical "resale transactions" at the end of the next three quarters. In total, ACS reported revenue of $124.5 million from such arrangements during fiscal 2009. ACS disclosed these transactions as "information technology outsourcing related to deliveries of hardware and software," which, per the SEC, did not accurately disclose the nature of these transactions and falsely suggested that they were executed as part of existing ACS outsourcing contracts.

As part of their compensation, the CEO and CFO of ACS received bonus payments that were, in part, tied to the company's financial performance, including revenue growth. As a result of the reported revenue, they appear to have received bonuses that were over 40% higher than they would have received if ACS had properly applied GAAP to determine the amount of revenue to report from the resale transactions.

Given the limited facts available in the release, ACS's "resale transactions" appear to meet neither gross nor net revenue recognition standards. The recorded transactions lacked substance and were "paper" transactions only, according to the SEC.

Is it possible that ACS could have, in good faith, believed that they were justified in recognizing revenue by securing documentation from the manufacturer describing a "sale." To properly record revenue, in addition to having a signed arrangement, making delivery, being sure of collectability, and having a fixed and determinable price, there must also be economic substance to the transaction. This is especially true for recording gross revenues from a sale, as compared to a net margin amount, if the company was serving in an agency capacity.

The accounting guidance related to assessing the substance of a transaction and whether or not gross revenue should be recognized is found in ASC 605-45-45, Other Presentation Matters. Some of the major considerations are listed below.

Indicators that support reporting ***gross revenue:***

- The entity is the primary obligor in the arrangement
- The entity has general inventory risk—before customer order is placed or upon customer return
- The entity has latitude in establishing price
- The entity changes the product or performs part of the service
- The entity has discretion in supplier selection
- The entity is involved in the determination of product or service specifications
- The entity has physical loss inventory risk—after customer order or during shipping
- The entity has credit risk

The following three indicators may support reporting ***net revenue***:

- The entity's supplier is the primary obligor in the arrangement
- The amount the entity earns is fixed
- The supplier has credit risk

Given the limited facts available in the release, ACS's "resale transactions" appear to meet neither gross nor net revenue recognition standards. The recorded transactions lacked substance and were "paper" transactions only, according to the SEC.

In addition, the available information does not describe how the accounts receivable from the transactions were recorded and paid. Certainly, if ACS paid for the product at no margin and the manufacturer "round tripped" the cash to pay the accounts receivable with no inventory ever being received, that would be another troubling fact. Without more information, it's difficult to draw clear conclusions as to whether the transactions reflected flawed application of accounting rules or, as Commissioner Luis A. Aguilar termed it, "egregious conduct."

Prior Period Comparisons: Year over Year and Quarterly Statistics

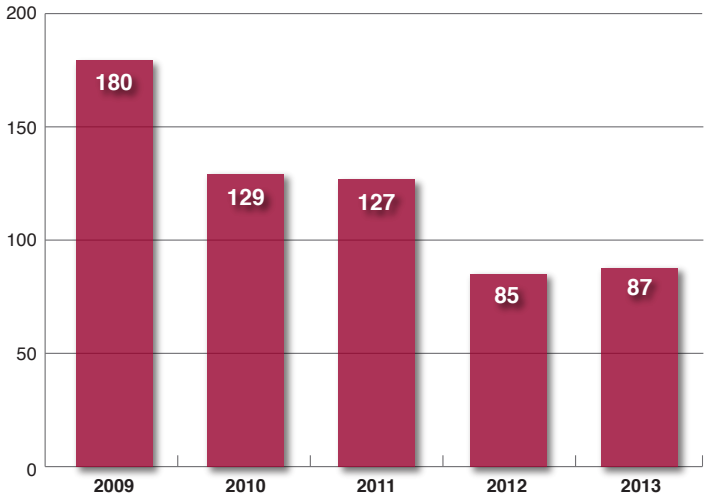
For the year ended December 31, 2013, the SEC issued 87 AAERs, remarkably the second lowest number of AAERs reported over the last five years.

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.

For the year ended December 31, 2013, the SEC issued 87 AAERs, remarkably the second lowest number of AAERs reported over the last five years. For comparison, the average rate for the periods 2009 through 2013 was approximately 122 releases, with the greatest number of releases issued in 2009.

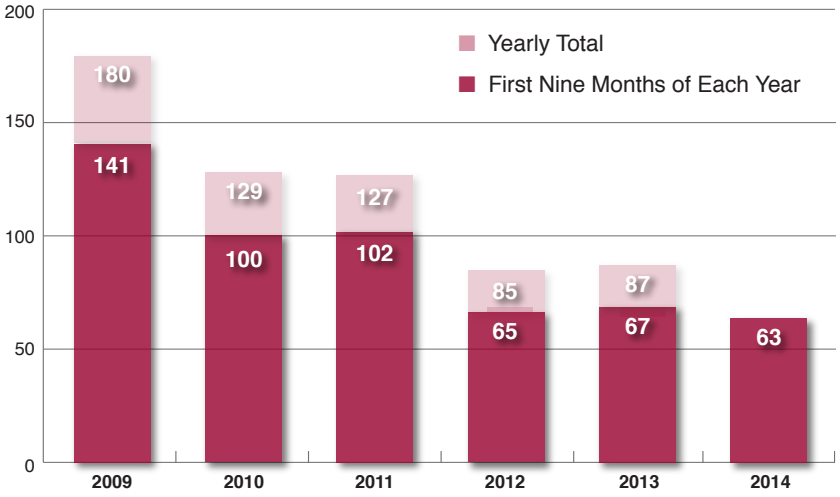
Looking Back at Total AAERs in Preceding Years

For the Periods January 1 - December 31,



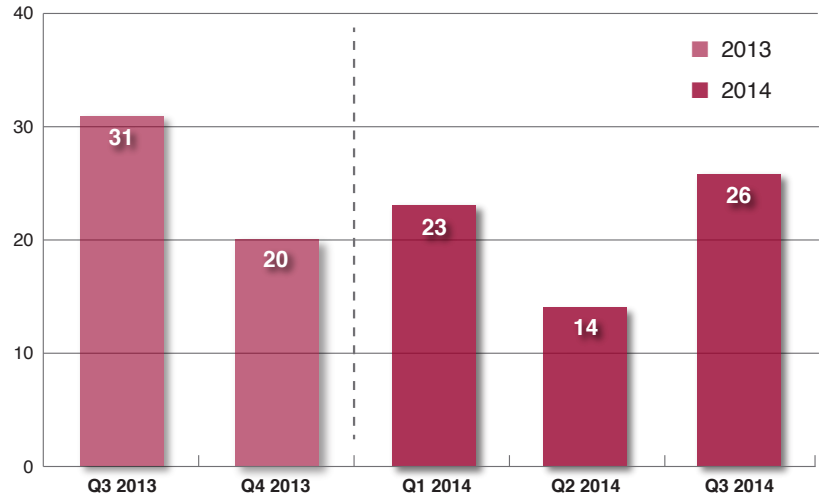
When analyzing the AAER population issued during the first nine months for the years 2009 through 2014, the 2014 results reflect a slight decrease from 2013, but a material drop from earlier years, as reflected below.

Analysis of AAER Volume for the First Nine Months of Each Year
For the Period Ended September 30,



When analyzing the AAER population issued over the last five quarters, we notice a slight increase in the trailing twelve months. However, over the last four quarters there have been 83 issuances, four releases less than the number of issuances the SEC posted in the 2013 fiscal year.

Quarter to Quarter AAER Number Comparison over One Year Period
Q3 2013 through Q3 2014



SEC NEWS: SPECIAL ANNOUNCEMENTS AND UPDATES

During the quarter ended September 30, 2014 the SEC announced several newsworthy items including the major developments described below.

SEC Announces Largest-Ever Whistleblower Award

Washington D.C., Sept. 22, 2014 —

The SEC announced an expected award of more than $30 million to a whistleblower who provided key original information that led to a successful SEC enforcement action.

The award will be the largest made by the SEC's whistleblower program to date and the fourth award to a whistleblower living in a foreign country, demonstrating the program's international reach.

"This whistleblower came to us with information about an ongoing fraud that would have been very difficult to detect," said Andrew Ceresney, Director of the SEC's Division of Enforcement. "This record-breaking award sends a strong message about our commitment to whistleblowers and the value they bring to law enforcement."

Sean McKessy, Chief of the SEC's Office of the Whistleblower, added, "This award of more than $30 million shows the international breadth of our whistleblower program as we effectively utilize valuable tips from anyone, anywhere to bring wrongdoers to justice. Whistleblowers from all over the world should feel similarly incentivized to come forward with credible information about potential violations of the U.S. securities laws."

The SEC's whistleblower program rewards high-quality, original information that results in an SEC enforcement action with sanctions exceeding $1 million. Whistleblower awards can range from 10 percent to 30 percent of the money collected in a case. The money paid to whistleblowers comes from an investor protection fund established by Congress at no cost to taxpayers or harmed investors. The fund is financed through monetary sanctions paid by securities law violators to the SEC. Money is not taken or withheld from harmed investors to pay whistleblower awards.

By law, the SEC protects the confidentiality of whistleblowers and does not disclose information that might directly or indirectly reveal a whistleblower's identity. The previous high for an SEC award to a whistleblower was $14 million, which was announced in October 2013.

The SEC awarded its first whistleblower under the program following its inception in fiscal year 2012. The program awarded four more whistleblowers in FY 2013, and has awarded nine whistleblowers in FY 2014.

"We're pleased with the consistent yearly growth in the number of award recipients since the program's inception," Mr. McKessy said. ■

SEC Announces Municipal Advisor Exam Initiative

Washington D.C., Aug. 19, 2014 —

The SEC announced that its Office of Compliance Inspections and Examinations (OCIE) is launching an examination initiative directed at newly regulated municipal advisors.

SEC rules that took effect on July 1 generally require municipal advisors to register with the SEC through the SEC's EDGAR system under the final registration process during a four-month phase-in period by October 31. The examinations are designed to establish a presence with the newly regulated municipal advisors. Over the next two years, OCIE plans to examine a significant percentage of these advisors using an approach that focuses on identified risks. Areas targeted for scrutiny may include the municipal advisor's compliance with its fiduciary duty to its municipal entity clients, books and recordkeeping obligations, disclosure, fair dealing, supervision, and employee qualifications and training.

"The municipal advisor examination initiative will focus on the areas that are most important to protecting issuers, investors, and municipal taxpayers," said Kevin Goodman, national associate director of OCIE's broker-dealer examination program. "We also will promote compliance by engaging these

new municipal advisor registrants through outreach."

John Cross, director of the SEC's Office of Municipal Securities, added, "The Office of Municipal Securities is committed to the protection of municipal issuers and investors. We look forward to continuing to collaborate with OCIE to support this municipal advisor examination initiative and work closely with other market participants to ensure effective implementation of this important new regulatory regime for municipal advisors."

The SEC is working with the Municipal Securities Rulemaking Board (MSRB) and the Financial Industry Regulatory Authority (FINRA) to facilitate a coordinated approach to oversight of municipal advisors. OCIE will examine municipal advisors for compliance with applicable SEC rules and applicable final MSRB rules once the MSRB rules are approved by the SEC and become effective.

Starting later this year, OCIE in coordination with FINRA and the MSRB will hold a Compliance Outreach Program for newly regulated municipal advisors where they will learn more about the examination process and their obligations under the Dodd-Frank Wall Street Reform and Consumer Protection Act and related rules. ■

SEC Announces Creation of New Office Within its Division of Economic and Risk Analysis

Office of Risk Assessment Will Coordinate Efforts to Create More Effective Data-Driven Risk Assessment Tools

Washington D.C., Sept. 11, 2014 —

The SEC announced the creation of a new office within the Division of Economic and Risk Analysis (DERA) that will coordinate efforts to provide data-driven risk assessment tools and models to support a wide range of SEC activities.

Since its creation in 2009, DERA has collaborated with market experts throughout the SEC to develop risk assessment tools. One example, the Aberrational Performance Inquiry, launched in 2009 to proactively identify atypical hedge fund performance, led to eight enforcement actions and is one of the tools used by the Division of Enforcement to assess private funds. Similarly, DERA developed a broker-dealer risk assessment tool that helps SEC examiners allocate resources by assessing a broker-dealer's comparative riskiness relative to its peer group. It also is working closely with the Enforcement Division's Financial Reporting and Audit Task Force and the Division of Corporation Finance on developing a tool to assist in identifying financial reporting irregularities that may indicate financial fraud and help assess corporate issuer risk.

"The Office of Risk Assessment will build on the existing expertise of DERA's staff, which includes economists, accountants, analysts, and attorneys, to provide sophisticated assessments of market risks. The establishment of this new office reflects the Commission's ongoing focus on deploying data-driven analytics to assist in routing scarce resources to areas of the greatest risks to the market," said DERA Deputy Director Scott W. Bauguess, who oversees the division's risk assessment activities.

Initial staffing of the new Office of Risk Assessment will be drawn from across DERA and the division will seek a new assistant director to head the office. The office will continue to develop and use predictive analytics to support supervisory, surveillance, and investigative programs involving corporate issuers, broker-dealers, investment advisers, exchanges, and trading platforms. In addition, the office will support the SEC's ongoing work related to the Financial Stability Oversight Council. ■

www.floydadvisory.com

ACKNOWLEDGEMENT
We wish to acknowledge the valuable contribution to this analysis by Liz Klyuchnikova and Genevieve S. Snow.

For more information, please contact George R. Ives at 646.449.7275

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.

New York
555 Fifth Avenue, 6th Floor
New York, NY 10017
212.867.5848

Boston
155 Federal Street, 14th Floor
Boston, MA 02110
617.586.1040