Floyd Advisory

Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended June 30, 2015

Q2 REPORT 2015

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 June 30, 2015.

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

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

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

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

Floyd Advisory
JULY 2015

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.

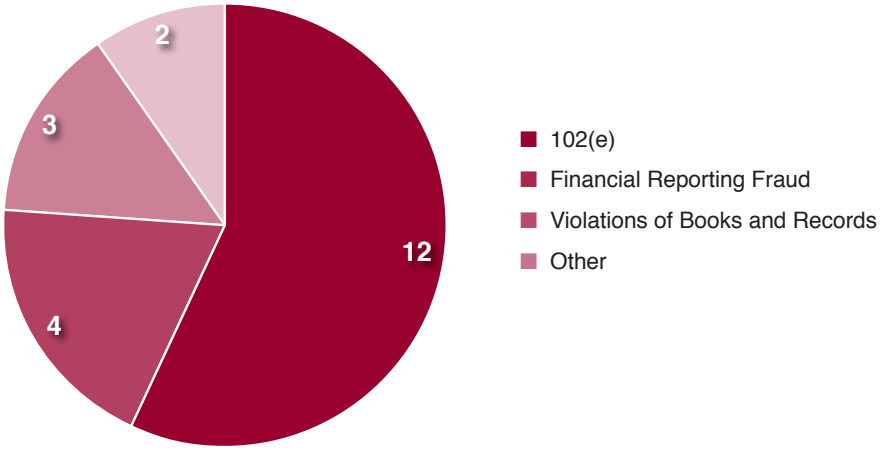
REVIEW PROCESS

- 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 Q2 2015 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed 21 AAERs during Q2 2015, which we have sorted into the following categories as shown in the pie chart.

Q2 2015 AAERs by Category



The SEC disclosed 21 AAERs for the quarter ended June 30, 2015.

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 approximately 57% of the releases issued in Q2 2015, the highest percentage compared to other categories that we have seen since Q1 of 2012. During the quarter, four out of the twelve Rule 102(e) actions were brought against financial statement auditors and audit firms. In addition, seven of the sixteen individuals who allegedly violated Rule 102(e) 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 stated that over a period of four years, an audit partner at an assurance, tax and consulting firm failed to conduct audits for several private funds in accordance with many Generally Accepted Auditing Standards ("GAAS"), including failing to maintain adequate professional skepticism, failing to supervise the audit, and failing to adequately document audit work.*** As a result, the SEC alleged that the partner aided and abetted and caused the adviser's violations of the Advisers Act's custody rule and engaged in improper professional conduct within the meaning of Rule 102(e) of the SEC's Rules of Practice.

  Specifically, the investment adviser to the audited private funds allegedly used fund assets to pay his own adviser-related operating expenses, transferring $3,452,353 from the funds over the course of four years. The SEC deemed these related party transactions material, which according to Generally Accepted Accounting Principles ("GAAP") should have been disclosed within the private fund financial statements. Nevertheless, the partner allegedly gave his final approval for issuance of audit reports containing unqualified opinions that financial statements for private funds were presented fairly in conformity with GAAP. The SEC issued a cease and desist order from committing or causing any violations against the audit partner and denied his privilege of appearing and practicing before the SEC as an accountant while imposing a civil money penalty in the amount of $75,000 to be paid within 30 days of the entry of the order.

- ***The SEC alleged that a biotechnology company along with its former CEO fraudulently issued and transferred millions of company shares to entities that the former CEO secretly controlled.*** According to the release, the former CEO, for his own benefit, directed the issuance and transfer of the company shares, and the subsequent sale of those shares into the open market, to generate an undisclosed amount of proceeds. In addition, the SEC stated that the company and the former CEO falsely recorded share issuances and transfers on the company's accounting books and records as repayments of loans that did not exist or payments for consulting services that were not performed. Moreover, it was alleged that the company and its CEO failed to disclose related party transactions in filings with the SEC, as required by GAAP. The former CEO allegedly directed the transfer of shares of the company stock without restrictive legends under circumstances where the transactions were not registered with the SEC and no exemption from the registration provisions applied. Finally, the release alleged that the former CEO falsely certified the accuracy of reports and statements that the company filed with the SEC. As a result, the individual was suspended from appearing or practicing before the SEC as an accountant.

"Changing the no admit-no deny settlement protocol for certain cases has, I believe, strengthened the impact and message of our enforcement program. Admissions can bring about greater public accountability, and that public accountability can boost investors' confidence and serve as a stronger deterrent. The new protocol will continue to evolve and grow."

Chair Mary Jo White
Washington, D.C.
June 4, 2015

Remarks Before the
SEC Historical Society

- ***According to the SEC, a public accounting firm associated with a public issuer audited annual reports from 2008 through 2014 for a client that periodically invested in the public issuer's stock, thereby impairing the auditor's independence.*** In addition to the public accounting firm's independence violations related to the audits, it was alleged that the firm's procedures were deficient in preventing such violations for all of its broker-dealer and investment fund audit clients. The SEC stated that the accounting firm lacked an appropriate system of quality controls to detect transactions by its attest clients related to the public issuer with whom the firm was associated. As a result, the SEC alleged, the firm did not ensure that those engagements complied with its legal and ethical requirements. According to the release, the public accountant's quality control and audit procedures failed to meet adequate professional standards with respect to its audits of this client.

  The public accounting firm was ordered to pay disgorgement of $65,245, which represented profits gained as the result of the alleged misconduct, prejudgment interest of $9,755, and civil penalties of $675,000.

There were four AAERs that we categorized as financial reporting frauds during the quarter, three of which arose from the same matter and are described in our Recommended Reading section.

Financial Reporting Frauds

There were four AAERs that we categorized as financial reporting frauds during the quarter, three of which arose from the same matter and are described in our Recommended Reading section. The remaining financial reporting fraud AAER is described below:

- ***A final judgement was entered against a former executive of a technology company alleging that, from 1999 through March 2001, he participated in fraudulent revenue recognition practices, including quarter-end "stuffing" of the company's distribution channel to help meet revenue and earnings targets imposed by company's CEO.*** The SEC first filed an AAER on this matter in 2004, imposing a $37 million civil penalty on the company, that was distributed to the victims of the alleged accounting fraud. The release alleged that the company and the other defendants engaged in numerous fraudulent accounting practices and other misconduct that had a cumulative net impact of over $230 million on the company's reported revenue and over $530 million on its pre-tax earnings.

In the current AAER regarding the former executive, the final judgment, to which the individual consented, permanently enjoins him from violating the Securities Exchange Act of 1934 and permanently bars him from serving as an officer or director of a public company. The judgment also requires the individual to pay disgorgement and prejudgment interest of $90,952, and it forgoes imposition of a civil monetary penalty based on his early and substantial cooperation with the SEC staff and the criminal authorities, as well as his guilty plea and sentence to three years' probation in a parallel criminal action brought by the United States Attorney's Office for the Eastern District of New York. The release stated that the SEC has now obtained final judgements against all thirteen former technology company executives named as defendants in three separate actions filed in connection with the company's alleged wide-range accounting fraud.

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. Two of the releases are worthy of detailed discussion:

- ***A matter involved the role of a former President and CEO, and a former Senior Vice President and Controller of a bank that is a wholly-owned subsidiary of a holding entity, in the alleged violations of the reporting, books and records, internal controls and certification provisions during the period ended June 30, 2009.*** According to the release, the violations resulted from the bank understating its loan losses for three large loans that quarter and consequently reporting positive net income of $342,000, despite previously reporting quarterly losses since September 30, 2008. The SEC stated that had the holding entity properly recognized loan losses for any of the three loans, it would have continued to report losses.

  Specifically, in the second quarter of 2009, the SEC alleged that the bank acted unreasonably in determining the amount by which it was required to recognize estimated losses for one large loan that had been foreclosed upon and two large impaired collateral dependent loans. In each of these instances, the bank allegedly substituted its own valuation analysis for that of an independent third party and in doing so did not reasonably estimate the market participant view of the fair value of the collateral. According to the release, because each of these instances resulted in the holding entity measuring impairment based on a value for the loan's underlying collateral that was greater than a fair value estimate consistent with GAAP, the entity recognized a lower loss on each of these assets in the second quarter of 2009. The SEC alleged that as a result of this conduct, the holding entity violated the reporting, books and records and internal control provisions of the Exchange Act. The individuals involved in misconduct were ordered to pay a total amount of $60,000 in civil penalties by the SEC.

"Many in-house lawyers, compliance professionals, and law firms representing companies have told us that since the implementation of our [whistleblower] program, companies have taken fresh looks at their internal compliance functions and made enhancements to further encourage their employees to view internal reporting as an effective means to address potential wrongdoing without fear of reprisal or retaliation. That is a very good thing..."

Chair Mary Jo White
Chicago, Illinois
April 30, 2015

The SEC as the Whistleblower's Advocate

- ***The SEC alleged that there was misconduct by a former Executive Vice President for a risk management credit division and other individuals while employed by the bank and its parent holding corporation.*** The release stated that during the quarter ended March 31, 2009, in accordance with the holding company's policies and procedures, personnel within the bank's special asset department initiated the procedures to place approximately $168 million of certain commercial loans into nonaccrual status. According to the SEC, the former Executive Vice President and other employees took steps to keep the loans in accrual status without adequate justification and supporting documentation. Such steps allegedly undertaken by the individuals to circumvent existing policies and procedures prevented the holding company from appropriately measuring impairment, which rendered its financial statements for the quarter ended March 31, 2009 materially misstated. As stated in the release, this also evidenced a failure by the holding company to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the loans were recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

Two AAERs were placed in the "Other" category this quarter.

Other

Two AAERs were placed in the "Other" category this quarter and one of them is described below:

- ***A proceeding was instituted against a former General Partner, Chief Financial Officer, and Chief Compliance Officer ("CFO") of an unregistered investment adviser who pled guilty to one count of perjury in violation of Title 18 United States Code.*** According to the SEC release, the criminal information to which the individual pled guilty stated that in March 2014, the former CFO took an oath pledging to testify truthfully in investigative testimony before the SEC. However, during such testimony, he falsely testified that earlier versions or drafts of a certain promissory note between him and the investment adviser existed, when in fact they did not. In May 2014, the SEC filed a lawsuit against the individual and others. In July and August 2014, the former CFO voluntarily met with SEC's attorneys and acknowledged the false testimony he provided previously. As the result, SEC barred the individual from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

The Q2 2015 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in Q2 2015 AAERs, we identified the accounting problem(s) in each AAER based on the classification definitions below:

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

"The cases that litigate are typically those where the evidence is less clear cut, the law is unsettled, the defendants have determined to spare no expense in attempting to clear their names, or, in many cases, all of the above."

Andrew Ceresney
Director
SEC Division of Enforcement
May 12, 2015

Keynote Speech at
New York City Bar 4th Annual
White Collar Institute

The following chart provides the results of our financial reporting issue analysis for the Q2 2015 AAERs.

Financial Reporting Issues Identified in Q2 2015 AAERs

Balance Sheet Manipulation is the leading category of accounting issues identified within AAERs in Q2 2015, the category that almost always leads the charts.

Balance Sheet Manipulation is the leading category of accounting issues identified within AAERs in Q2 2015, the category that almost always leads the charts. Some of the most prevailing issues within this group included overvalued loans and overstated value of inventory on the companies' books and records.

Notable Q2 2015 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 of a technology company in a case that focuses on the importance the of understanding the risks and uncertainties around accounting for long term contracts. Next, our discussion highlights the importance of a public company performing effective due diligence prior to acquiring a private company and, once complete, implementing, or improving, internal controls over financial reporting.

Accounting and Auditing Enforcement Release No. 3662 / June 5, 2015, Administrative Proceeding File No. 3-16575

Computer Sciences Corporation ("CSC") is a multinational company providing information technology services. The SEC alleged that from 2009 through 2011, CSC engaged in a wide-ranging accounting and disclosure fraud that materially overstated the company's earnings. The most significant issues surrounded CSC's accounting and disclosures related to a long-term contract to provide software and services to the UK's National Health Service ("NHS").

Some of the most significant misconduct alleged by the SEC included:

- The former CEO and CFO of the company failed to make required disclosures, and made misleading statements to investors about the contract with the NHS, the company's largest and most high profile contract.
- CSC's former Finance Director prepared a fraudulent accounting model in which he included made-up assumptions to avoid a negative charge to CSC's earnings related to the NHS contract.
- CSC overstated revenue and income by recording revenue that was based on proposed contract amendments with the NHS that were never ultimately executed.
- CSC also failed to disclose that, during the relevant time period, a significant source of its operating cash flows were advances from NHS. While GAAP allows these cash flows to be classified as operating, they were in essence loans upon which CSC had to pay 5% interest. CSC ultimately repaid 93% of the advances.
- As this was occurring in the United States and the United Kingdom, senior CSC finance personnel in Australia overstated the company's earnings using "cookie jar" reserves and by failing to record expenses as required.
- Separately, CSC finance personnel in Denmark engaged in a variety of fraudulent accounting manipulations that also overstated the company's earnings.

We selected this release for recommended reading as it highlights the risks and uncertainties that surround the accounting for long-term contracts under GAAP. Accounting for long-term contracts typically requires a registrant to make significant judgments and estimates. As time passes, those judgments and estimates must be constantly updated, often resulting in volatility in a company's earnings. Best practices surrounding the accounting for long-term contracts include robust disclosure about sensitive judgments made by management so that the investor can make a reasonable assessment of the quality of, and risks inherent in, a registrant's earnings in any particular period. Alternatively, the lack of disclosure (or misleading disclosure) renders the financial statements misleading and of little practical use to investors.

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The NHS Contract

According to the SEC, in 2003, CSC and other IT contractors entered into long-term contracts with the NHS to build and deploy an electronic patient records system by 2013. By 2007, CSC had assumed control of most of the contract throughout the UK, and had the opportunity to earn as much as $5.4 billion through its completion. However, as stated in the release, in order to incentivize CSC to complete its work on a timely basis, the contract included penalties of up to $160,000 per day for missed milestones. The SEC stated that in 2008 CSC began to experience significant delays and began missing deployment milestones. As a result, CSC allegedly entered in an amended agreement with NHS called "SARPA" in April of 2009 that gave the company additional time to meet deadlines, but also created significant financial risks to CSC if it failed to meet the new deadlines.

It was alleged that the CSC's management had substantial doubts about the company's ability to meet even the new extended deadlines set forth in SARPA. In fact, according to the release, one week after filing its FY 2009 10-K, CSC missed the first of many milestones in the contract. Despite this, the 10-K for the fiscal year 2009 stated that the NHS contract was profitable and that CSC expected to recover the amounts it had invested in the contract as stated by the SEC. By July of 2009, as stated in the release, the CEO had been told that deployments were not occurring as anticipated, and recommended renegotiations with the NHS with regard to late penalties and deployment timeframes. Shortly thereafter, during its earnings call for the first quarter of 2010, CSC's CEO allegedly told investors the opposite—that CSC "had completed all activities scheduled within the quarter" and was on track with regard to the next key contractual milestone.

"Successful litigation sanctions wrongdoers, provides relief to victims, and deters wrongdoing. In addition to victories in the specific cases we bring to trial, the SEC's litigation efforts also help us obtain strong settlements in other cases by making clear that we will go deep into litigation and to trial, if necessary, in order to obtain appropriate relief."

Andrew Ceresney
Director
SEC Division of Enforcement
May 12, 2015

Keynote Speech at
New York City Bar 4th Annual
White Collar Institute

Simultaneously, in June of 2009, CSC's team in charge of the NHS account, led by the firm's former Finance Director, updated the percentage-of-completion model to reflect the accounting effects of revised deployment estimates and related delay penalties. The revised model allegedly estimated that CSC would fall over $1 billion short of the original $5.4 billion revenue target for the NHS contract. In contrast to previously forecasted profit margin on the NHS contract of 16%, the release stated that the percentage-of-completion model now showed that the NHS contract would generate a significant loss for CSC. This was critical, as GAAP not only required that CSC make an inception-to date adjustment to effectively reverse all profits reported in prior periods that the company now believed would never be realized, but also required to record the *entire amount of the expected loss* on the contract in the current period.

This, however, is not what occurred. The SEC alleged that in September 2009, in order to close this "gap" in forecasted earnings and drive the profit margin back to previous levels, the former Finance Director instructed his team to insert hundreds of millions of dollars revenue into the accounting model associated with products CSC had stopped developing and that the NHS had indicated it was not intending to purchase. The SEC stated that the model was also changed to reflect estimated future price increases that lacked any contractual support and therefore violated the GAAP requirement that revenue only be recognized when amounts are "fixed and determinable."

According to the AAER, in November 2009 CSC entered into negotiations with the NHS to amend SARPA. The negotiations were conducted intermittently over a two-year period, but at no point did the parties amend SARPA as was specified by the release. Further, the SEC alleged that the NHS repeatedly advised CSC over this time period that SARPA remained the operative contract. Nevertheless, beginning in December 2009, CSC allegedly revised its percentage-of-completion model to reflect proposed SARPA amendments that had not been finalized (and ultimately never would). Among other effects, this resulted in CSC modeling significantly higher prices than were called for in SARPA. Including such proposed contract revisions prior to their approval by the customer was a direct violation of GAAP. As a result of these revisions, CSC's maintained the previously estimated 16% profit margin.

Ultimately, the release stated that after approximately two years of failed negotiations with the NHS, in December 2011 CSC filed an 8-K disclosing that the NHS would not approve of any of CSC proposed amendments and that it would be required to recognize a material impairment on its net investment on the contract. In its third quarter 10-Q, filed on February 8, 2012, CSC wrote down approximately $1.5 billion of NHS contract-related assets from its balance sheet.

Other Allegations and Settlement

In addition to the alleged improper accounting for the NHS contract discussed above, the SEC alleged various other improprieties and disclosure issues related to, among other things, cash advances from NHS, as well as the use of "cookie-jar reserves" and other improper accounting practices by various CSC subsidiaries.

CSC paid a civil monetary penalty of $19 million as part of the settlement, according to the release. In addition, three former CSC executives were sanctioned under section 102(e) of the securities laws and are prohibited from practicing before the SEC in the future. Finally, the settlement required CSC to engage an "independent ethics and compliance consultant." The consultant was required to report to both the SEC and CSC's management the results of his or her review, which was to include the following:

- Whether CSC's internal controls are sufficient to provide reasonable assurance that it is maintaining fair and accurate books and records (with a particular emphasis on revenue accounting),
- An assessment of CSC's disclosure controls,
- Whether CSC's corporate culture has any impact on its ability to comply with its disclosure obligations, and
- An assessment of CSC's compliance and ethics function, including training as well as anti-retaliation policies and whistleblower protections.

CSC was required to provide the consultant with complete access and resources to review key documents, according to the SEC, and to implement the consultant's recommendations within 120 days of receipt.

"Litigation and trials are among the most important work of the Commission's Enforcement staff and we have dedicated the necessary resources to ensure that we have and will continue to have a strong record of success."

Andrew Ceresney
Director
SEC Division of Enforcement
May 12, 2015

Keynote Speech at
New York City Bar 4th Annual
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Accounting and Auditing Enforcement Release No. 3647, 3648, 3649 / April 1, 2015, Administrative Proceeding File No. 3-16469, In the Matter of Marc J. Mize, Administrative Proceeding File No. 3-16470 In the Matter of Michael Hedrick, Administrative Proceeding File No. 3-16471 In the Matter of Timothy Edwin Scronce.

Three releases issued during the second quarter relate to an alleged fraudulent scheme to overstate assets and revenue that was executed by three former senior executives of four private telecommunication companies (collectively "TelWorx") that were acquired by a public company, PCTEL Inc. ("PCTEL"). This matter highlights the risks associated with acquisitions, particularly when a public company acquires a private company. Among the areas of potential focus are:

- The importance of performing effective due diligence prior to making an acquisition to ensure the accuracy of the historical earnings, which often form the basis for the purchase price, as well as the foundation for future revenue and earnings forecasts.
- The need for a public company that has acquired a private company to immediately implement, or improve, internal controls over financial reporting sufficient to meet the requirements of Sarbanes-Oxley.
- The importance of ensuring that there is a strong ethics and compliance program in place, including whistleblower protections, that is communicated to all employees.
- The need to identify key risks inherent in certain deal structures, such as those that include earnout payments, particularly when the former owner of the acquiree remains in an executive position overseeing the operations of the acquiree in the post-acquisition period.

In the first half of 2012, PCTEL negotiated with the majority-owner and the CEO of TelWorx to acquire assets of the private company. The price to be paid at the acquisition was determined, in part, by the target company's earnings before interest, depreciation, and amortization ("EBIDTA"), and included both cash and an earnout payment to be based on TelWorx's 2013 performance as a subsidiary of PCTEL and paid in PCTEL's common stock. Certain members of TelWorx's existing executive team—including the CEO—would remain in charge of day-to-day operations subsequent to the acquisition.

Prior to the completion of the acquisition, the former CEO of TelWorx allegedly directed the former company Controller to improperly inflate the value of certain obsolete telecommunications equipment in TelWork's inventory, the effect of which was to improperly inflate the company's EBITDA by understating cost of goods sold. Furthermore, the former CEO directed that certain invoices, specifically those for customer orders that had been placed but not yet shipped in the second quarter of 2012, be backdated to the first quarter. The effect of this alleged misconduct was to improperly overstate revenue and earnings in the second quarter of 2012.

"I would urge that, especially in the post-financial crisis era when regulators and right-minded companies are searching for new, more aggressive ways to improve corporate culture and compliance, it is past time to stop wringing our hands about whistleblowers. They provide an invaluable public service, and they should be supported. And, we at the SEC increasingly see ourselves as the whistleblower's advocate."

Chair Mary Jo White
Chicago, Illinois
April 30, 2015

The SEC as the Whistleblower's Advocate

After the acquisition in the third quarter, PCTEL began performing inventory valuation testing at TelWorx that would have included the overvalued telecommunications equipment. According to the SEC, the former CEO of TelWorx told the former Controller that he intended to purchase the equipment himself. He allegedly instructed the Controller to issue false invoices to a telecommunications vendor in Taiwan who would stand in as a purchaser. The release stated that the former CEO then paid the invoices without ever informing PCTEL that he had purchased the equipment himself and that the equipment had never shipped.

Despite the alleged false order recorded in TelWorx's book and records, by the end of the third quarter, TelWorx was still going to fall short of its revenue forecast. According to the release, the shortfall was largely due to a forecasted order from a large customer that did not come in during the quarter. The former CEO allegedly identified an "intermediate purchaser" to buy the purportedly overvalued equipment—a TelWorx vendor. The former Vice President of Sales allegedly approached the vendor and facilitated the arrangement. The release claims that the arrangement was for the intermediate purchaser to be invoiced for the goods and then later resell them to the end customer, making the payment when the order eventually occurred. The intermediate purchaser allegedly received extended payment terms intended to effectively match the timing of payment expected from the end customer. The goods were never actually invoiced or shipped to the intermediate purchaser.

By the fourth quarter, the order from the large customer still had not been placed. According to the release, the former CEO directed certain TelWorx employees to falsify documents and records in an attempt to hide the aging account receivable on the TelWorx's books. In the first quarter of 2013, PCTEL uncovered the scheme and filed an 8-K/A with the SEC disclosing the irregularities.

As a result of its investigation into the actions of the former CEO, PCTEL reached a settlement with him that effectively refunded a substantial portion of the purchase price of TelWorx. PCTEL also recorded a goodwill impairment in the fourth quarter of 2012 relating to substantially all of the goodwill recorded as a result of the TelWorx acquisition.

The SEC entered into settlements with all three individuals involved in the alleged fraud. According to three separate releases, the SEC entered cease and desist orders against the former majority owner and CEO of TelWorx, the former Controller at TelWorx, and the former Senior Vice President of Sales and Tech Services of PCTelWorx that halts the three respondents from committing or causing any future violations of the Securities Exchange Act. The SEC also ordered the former CEO to pay disgorgement of $376,007, prejudgment interest of $29,212.47, and a civil money penalty of $140,000. The Controller, according to the SEC, had entered into a cooperation agreement with the Division of Enforcement and was ordered to pay disgorgement of $25,000 and prejudgment interest of $2,072.62. Finally, the release stated that the former Senior Vice President of Sales and Tech Services was ordered to pay $25,000 in civil penalties.

"...the bar has been raised for what counts as good corporate citizenship in the last 15 years or so. For example, internal investigations have now become common, a clear best practice for any company that discovers significant potential misconduct. And sharing the results of those internal investigations with the government has become commonplace, as companies recognize the immense benefits that can accrue to them from doing so."

Andrew Ceresney
Director
SEC Division of Enforcement
Dallas, Texas
May 13, 2015

The SEC's Cooperation Program: Reflections on Five Years of Experience

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.

For the year ended December 31, 2014, the SEC issued 93 AAERs, representing a slight increase in the volume of AAERs reported over the previous two years. But the volume is still significantly lower than the volume of AAERs issued by the SEC just four to five years ago. The volume of AAERs in 2014 represents 48% fewer enforcement releases than 2009.

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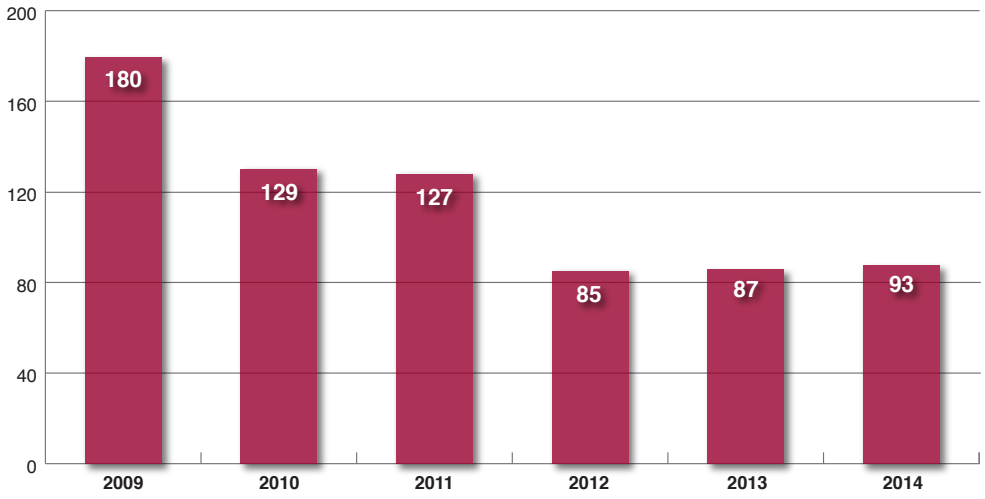
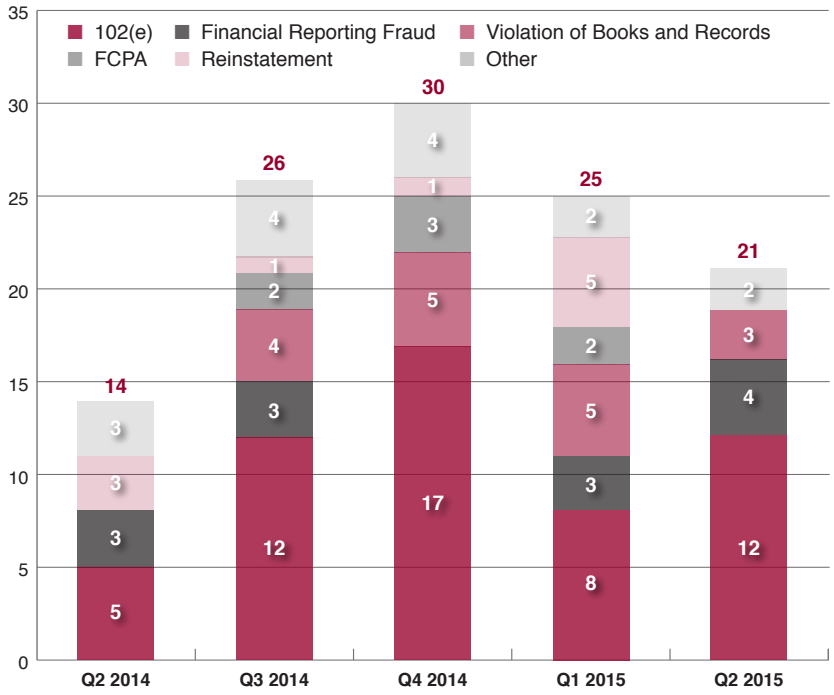
Looking Back at Total AAERs in Preceding Years
For The Periods January 1 – December 31,



When analyzing the AAER population issued over the last five quarters, we notice a slight increase in the number of releases in the trailing twelve months. Over the last four quarters there have been 102 issuances compared to 95 in the trailing four quarters that we reported just last quarter. This is nine releases more than the number of issuances the SEC posted in the 2014 fiscal year.

Notably, we can see that 102(e) violations have been the dominating category throughout the period. In addition, there were no FCPA cases reported in Q2, 2015; interestingly, the same happened in Q2 of last year. There were no reinstatement cases this quarter either, compared to five reported in Q1, 2015.

Quarter to Quarter AAER Comparison Over Period of Last Five Quarters
Q2 2014 through Q2 2015



Over the last four quarters there have been 102 issuances compared to 95 in the trailing four quarters that we reported just last quarter. This is nine releases more than the number of issuances the SEC posted in the 2014 fiscal year.

SEC NEWS: SPECIAL ANNOUNCEMENTS AND UPDATES

During the quarter ended June 30, 2015 the SEC announced several newsworthy items including the major developments described below.

SEC Announces Million-Dollar Whistleblower Award to Compliance Officer

Washington D.C., April 22, 2015 —

The SEC announced an award of more than a million dollars to a compliance professional who provided information that assisted the SEC in an enforcement action against the whistleblower's company.

The award involves a compliance officer who had a reasonable basis to believe that disclosure to the SEC was necessary to prevent imminent misconduct from causing substantial financial harm to the company or investors.

"When investors or the market could suffer substantial financial harm, our rules permit compliance officers to receive an award for reporting misconduct to the SEC," said Andrew Ceresney, Director of the SEC's Division of Enforcement. "This compliance officer reported misconduct after responsible management at the entity became aware of potentially impending harm to investors and failed to take steps to prevent it."

The whistleblower in this matter will receive between $1.4 million and $1.6 million. Whistleblower awards can range from 10 percent to 30 percent of the money collected in a successful enforcement action with sanctions exceeding $1 million. By law, the SEC must protect the confidentiality of whistleblowers and cannot disclose information that might directly or indirectly reveal their identities.

Since its inception in 2011, the SEC's whistleblower program has paid more than $50 million to 16 whistleblowers who provided the SEC with unique and useful information that contributed to a successful enforcement action. All payments are made out of an investor protection fund established by Congress that is financed entirely through monetary sanctions paid to the SEC by securities law violators. No money is taken or withheld from harmed investors to pay whistleblower awards.

This is the second award the SEC has made to an employee with internal audit or compliance responsibilities. ■

SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements

Agency Announces First Whistleblower Protection Case Involving Restrictive Language

Washington D.C., April 1, 2015 —

The SEC announced its first enforcement action against a company for using improperly restrictive language in confidentiality agreements with the potential to stifle the whistleblowing process.

The SEC charged Houston-based global technology and engineering firm KBR Inc. with violating whistleblower protection Rule 21F-17 enacted under the Dodd-Frank Act. KBR required witnesses in certain internal investigations interviews to sign confidentiality statements with language warning that they could face discipline and even be fired if they discussed the matters with outside parties without the prior approval of KBR's legal department. Since these investigations included allegations of possible securities law violations, the SEC found that these terms violated Rule 21F-17, which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC.

KBR agreed to pay a $130,000 penalty to settle the SEC's charges and the company voluntarily amended its confidentiality statement by adding language making clear that employees are free to report possible violations to the SEC and other federal agencies without KBR approval or fear of retaliation.

"By requiring its employees and former employees to sign confidentiality agreements imposing pre-notification requirements before contacting the SEC, KBR potentially discouraged employees from reporting securities violations to us," said Andrew J. Ceresney, Director of the SEC's

Division of Enforcement. "SEC rules prohibit employers from taking measures through confidentiality, employment, severance, or other type of agreements that may silence potential whistleblowers before they can reach out to the SEC. We will vigorously enforce this provision."

According to the SEC's order instituting a settled administrative proceeding, there are no apparent instances in which KBR specifically prevented employees from communicating with the SEC about specific securities law violations. However, any company's blanket prohibition against witnesses discussing the substance of the interview has a potential chilling effect on whistleblowers' willingness to report illegal conduct to the SEC.

"KBR changed its agreements to make clear that its current and former employees will not have to fear termination or retribution or seek approval from company lawyers before contacting us." said Sean McKessy, Chief of the SEC's Office of the Whistleblower. "Other employers should similarly review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC."

Without admitting or denying the charges, KBR agreed to cease and desist from committing or causing any future violations of Rule 21F-17.

The SEC's investigation was conducted by Jim Etri and Rebecca Fike and supervised by David L. Peavler of the Fort Worth Regional Office. ■

SEC Announces Outreach Programs to Help Firms Comply With Regulation Systems Compliance and Integrity

Washington D.C., May 5, 2015 —

The SEC announced it has opened registration for outreach programs to help firms comply with an SEC rule that aims to protect investors by strengthening the technology underpinning U.S. securities markets.

The Commission adopted Regulation Systems Compliance and Integrity, or Regulation SCI, in November 2014 and compliance with many of its requirements begins this fall. Those subject to Regulation SCI are required to have comprehensive policies and procedures for their technological systems, conduct business continuity testing, annually review their automated systems and take appropriate corrective action when system issues occur.

The SEC's Office of Compliance Inspections and Examinations (OCIE) Technology Controls Program, in coordination with the SEC's Division of Trading and Markets, is sponsoring the compliance outreach program. The program is targeted to Chief Information Officers, Chief Information Security Officers, and other senior personnel responsible for enhancing their firms' systems compliance and integrity programs.

Outreach programs will be held on July 16 at the SEC's New York Regional Office and on July 29 at the SEC's Chicago Regional Office. The events will include panel discussions on the regulatory framework of Regulation SCI, compliance obligations, and the monitoring and examination processes.

"The compliance outreach program provides an opportunity for the SEC and regulated entities to discuss compliance issues associated with Regulation SCI," said OCIE Acting Director Marc Wyatt. "We look forward to exchanging information and discussing ways to strengthen the technology infrastructure of the U.S. securities markets." ■

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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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