Floyd Advisory

BUSINESS CONSULTANTS | FORENSIC ACCOUNTANTS

Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended September 30, 2013

Q3 REPORT 2013

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, 2013.

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

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

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

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

Floyd Advisory
OCTOBER 2013

Our Process and Methodology

The SEC identifies and discloses accounting and auditing related enforcement actions from within its population of civil lawsuits brought in federal court, and its notices and orders concerning the institution and/or settlement of administrative proceedings as Accounting and Auditing Enforcement Releases ("AAERs"). Importantly, the disclosed AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all of the actions that may fit into the definition above.

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

As part of our review, we gathered information and key facts, identified common attributes, noted trends, and observed material events. Applying our professional judgment, which is based solely on information provided by the SEC, we sorted the releases into major categories (e.g., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC, 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.

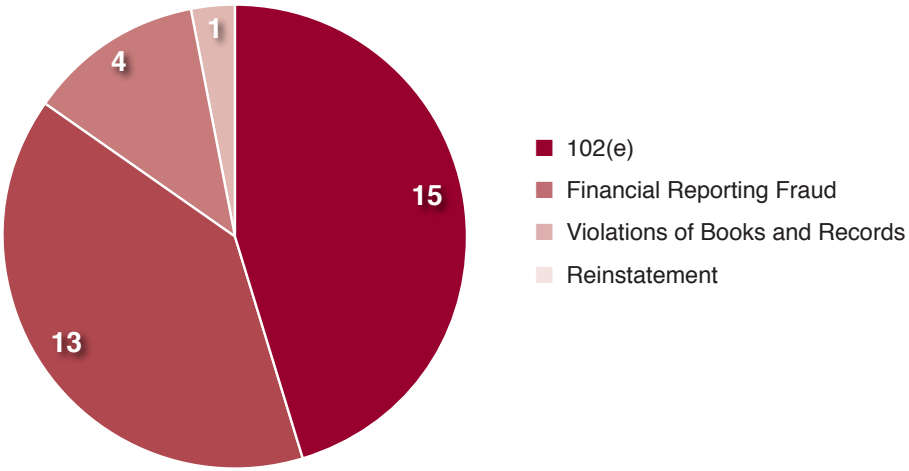
REVIEW PROCESS

- 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 2013 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed 33 AAERs during Q3 2013 which we have sorted into the following categories as shown in the pie chart.

Q3 2013 AAERs by Category



AAERs reported by Category for Quarter Ended September 30, 2013:

33

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 45% percent of the releases issued in Q3 2013. Rule 102(e) actions involve the censure and denial, temporarily or permanently, of the privilege of appearing or practicing before the SEC. For accountants, the standards under which one may be penalized with a Rule 102(e) action include reckless, as well as negligent conduct, 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 include:

- ***The CFO of a public financial services company, who is also a certified public accountant, caused the registrant to improperly recognize revenue on interest from borrowers where the borrowers were not paying and where the borrowers' impaired financial condition meant that collectability was not reasonably assured.*** Recognition of revenue in these circumstances

would not comply with generally accepted accounting principles ("GAAP") and actually departed from the financial services company's own revenue recognition policy, which stated that the company would not recognize revenue when the payment of interest was 90 days past due.

- ***A major audit firm partner, who is a certified public accountant, violated the independence rules by providing a friend with inside information related to five audit clients in return for cash and other items of value as compensation.*** On at least 18 occasions between October 2010 and February 2013, the audit firm partner disclosed material non-public information concerning five of his firm's corporate clients to his friend who traded in the companies' securities prior to related corporate announcements. The audit firm issued audit reports and reviewed quarterly financial statements for the five corporate clients in connection with and following these announcements. The audit firm partner's conduct caused his firm to violate the independence rules with respect to the five clients. These violations in turn caused the five clients to make filings with the SEC that did not comply with the issuers' reporting requirements. After the audit firm learned of the partner's conduct, it resigned from two audit engagements, withdrew previously issued audit reports for these clients, and withdrew reports on the effectiveness of their internal control over financial reporting.

- ***An audit partner in a now-defunct accounting firm did not comply with PCAOB Standards when, in connection with the audit procedures performed related to his client's accounting for deferred taxes and the income tax provision, he failed to detect material errors, failed to exercise due professional care and professional skepticism, failed to obtain the necessary training and proficiency in the area of income taxes, failed to adequately plan and supervise the audits, failed to obtain sufficient competent evidential matter, and failed to prepare and retain adequate work paper documentation.*** The auditor thereby engaged in improper professional conduct in connection with the audits of his client's financial statements from 2006 through 2008 within the meaning of Rule 102(e)(1)(ii) of the SEC's Rules of Practice.

Rule 102(e) actions accounted for 45% percent of the releases issued in Q3 2013. Rule 102(e) actions involve the censure and denial, temporarily or permanently, of the privilege of appearing or practicing before the SEC.

Financial Reporting Frauds

Examples of actions related to financial reporting frauds described in the Q3 2013 releases include:

- ***The SEC filed fraud and related charges against a China-based jewelry company, its chairman of the board of directors and former chief executive officer ("CEO") and president, who agreed to settle the SEC's claims against them.*** The SEC alleged that the company failed to disclose cash transfers of approximately $134 million to three purportedly unknown entities. The transfers were allegedly directed and authorized by the CEO and occurred between September 11, 2009 and November 24, 2010. The company's board of directors was not aware of and did not approve the cash transfers. The transactions were made without any written agreement or repayment terms.

FINANCIAL REPORTING AND ACCOUNTING FRAUD

"I find it hard to believe that we have so radically reduced the instances of accounting fraud simply due to reforms such as governance changes and certifications and other Sarbanes-Oxley innovations. The incentives are still there to manipulate financial statements, and the methods for doing so are still available. We have additional controls, but controls are not always effective at finding fraud."

Andrew Ceresney
Co-Director of the
Division of Enforcement
U.S. Securities and
Exchange Commission
American Law Institute
Continuing Legal Education
Washington, D.C.
September 19, 2013

Although the company has been unable to obtain independent third-party verification for a majority of the underlying cash transfers to or from the company's bank accounts, internal company records indicate that the transferred funds were returned to the company throughout the same period. The company lacked adequate internal accounting controls and incorrectly recorded the cash transfers in its books and records as increases or decreases in "other payables" or "prepaids" accounts, causing the company's public filings to be materially misstated.

In the settled complaint, the SEC alleges that the former chairman of the board of directors and the CEO and president violated the antifraud provisions of the securities laws. The SEC further alleges violations of reporting, recordkeeping, and internal controls provisions of the federal securities laws. Without admitting or denying the allegations, the individuals have consented to the entry of a final judgment that: (i) permanently enjoins them from future violations of the federal securities laws; (ii) orders them to pay civil penalties of $1 million and $150,000, respectively; and (iii) bars the former CEO and president from serving as an officer and director for five years. The proposed settlement is subject to approval by the court. The SEC also announced the entry of an order revoking the registration of each class of registered securities of the company for failure to make required periodic filings.

- ***The SEC charged the founder/CEO/CFO of a religious-themed video game manufacturer and his friend with scheming to falsely inflate the company's revenue through sham circular transactions.*** The SEC alleges that the founder caused the company to issue almost two billion shares of stock to his friend as purported compensation for consulting services. The true purpose of the arrangement was to enable the friend to sell millions of unregistered shares of the company to the market and then kick back a portion of his stock proceeds to the company in order to inflate its revenue at a time when it was in need of funds. According to the allegations, the friend sold approximately $4.6 million worth of stock in 2009, transferred approximately $3.3 million back to the company in 2009 through 2010, characterized as fees and revenues for the company, and retained almost $1.3 million for his personal use. The company has since terminated all of its employees due to its poor financial condition and the SEC has suspended the registration of its stock. The complaint seeks permanent injunctions, financial penalties, and penny stock bars against the individuals, and an officer-and-director bar against the former executive. The SEC investigation is ongoing.

- ***The SEC announced the filing of fraud and related charges against a China-based travel services company, its former CEO and chair as well as its former director, secretary, and interim CFO.*** The SEC alleges that the company failed to disclose cash transfers of approximately $41 million to thirty-four unknown entities in Hong Kong and China between September 2008 and March 2011. Further, the SEC alleges that the defendants falsely described the company's business organization, failing to disclose that the company had transferred certain subsidiaries to third parties pursuant to agreements designed to give the company the economic benefits of ownership. The SEC further alleges that the company materially overstated its revenues and profits in its quarterly reports in 2010.

Finally, in 2010, the company is also alleged to have failed to obtain an auditor's attestation to its assessment of internal controls. The individual defendants are alleged to have knowingly failed to establish proper internal controls, caused documents to be falsified, and falsely certified the effectiveness of the company's internal controls for 2010. The company and the individuals settled for an aggregate amount of $935,000, without admitting or denying the allegations.

- ***The SEC charged two former bank executives for failing to recognize in the bank's financial statements a probable loss on one of the bank's largest troubled loans.*** The SEC alleges that, prior to the end of the third quarter in 2010, one of the former executives knew that the borrower in a shared national credit loan for a large residential real estate development was unwilling or unable to contribute the necessary funds to complete the project, which served as collateral for the loan. He also knew that the collateral had declined significantly in value. After the third quarter but still weeks before the bank's quarterly report was filed, both former executives learned that the borrower had missed a loan payment and declared bankruptcy. Based on these and other events, GAAP required the bank to recognize a loan loss in its third quarter financial statements, yet the bank failed to do so. According to the SEC's complaint, the failure to report the loan loss caused the bank to falsely state that its main subsidiary bank had met certain capital ratio thresholds required by the Federal Deposit Insurance Corporation. The bank also understated its net loss for the quarter and the nine months ending September 30. The former executives agreed to settle the SEC's charges by paying penalties of $100,000 each and being barred from acting as an officer or director of a publicly traded company, without admitting or denying the SEC's allegations.

- ***The SEC filed fraud and other related charges against a Chinese lighting company and a Chinese consumer electronics company and their respective CEOs, who are siblings.*** The SEC alleges that the parties engaged in fraudulent schemes to raise and divert offering proceeds and then attempted to hide the diversions by lying to auditors and making false and materially misleading filings with the SEC. The companies are U.S. issuers that raised approximately $7.7 million and $21.5 million, respectively, in publicly registered offerings in the U.S. capital markets in 2010. Specifically, on June 24, 2010, $7.7 million in offering proceeds was deposited into the lighting company's Hong Kong bank account. The next day, the company CEO transferred approximately $6.8 million, or almost 90%, to a company that has no disclosed relationship with the lighting company, but told the company's auditor that the funds remained in the lighting company's account. Similarly, on April 26, 2010, $21.5 million in offering proceeds was deposited in the consumer electronics company's Hong Kong bank account. Even though almost all of the money was transferred out of the Hong Kong bank account by May 5, 2010, the electronics company CEO told the company's auditor that the funds continued to be held in the account. In addition to lying to auditors in order to mask the diversions, the defendants falsified bank and accounting records to reflect inflated cash balances and filed false and misleading quarterly reports on Forms 10-Q with the SEC that contained inflated cash balances. In addition, the defendants filed registration statements that misled investors about how the offering proceeds would be used.

DEPLOYING THE FULL ENFORCEMENT ARSENAL

"In 2012, the SEC changed the no-admit-no-deny language as it applied to settlements with parties that have pled guilty in a related criminal action. In these cases, we now explicitly reference these admissions in the SEC settlement. It was a first step towards greater accountability, and a good one."

Chairman Mary Jo White
U.S. Securities and Exchange Commission
Council of Institutional Investors Fall Conference
Chicago, IL
September 26, 2013

In its complaint, the SEC alleges that the defendants violated the antifraud provisions of the securities laws. The SEC seeks permanent injunctive relief to prevent future violations of the federal securities laws, disgorgement of ill-gotten gains with prejudgment interest, civil penalties, officer and director bars, and any other appropriate relief. The SEC also announced the entry of an order instituting administrative proceedings to determine whether the registration of each class of securities of the companies should be revoked for failure to make required periodic filings.

Violations of Books and Records Rules

This quarter there were four AAERs related to books and records violations, 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.

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- ***A manufacturer and distributer of weight loss and other health and diet products restated its financial statements for 2006, 2007, and 2008 related to improper accounting for its income tax provision for the affected years, which resulted in material understatements of its income tax expense and material overstatements of its net income after tax.*** The company's inaccurate financial statements resulted in part from improper accounting that did not comply with GAAP and from a deficient system of internal controls that failed to ensure the appropriate recording and reporting of its income tax expense. Soon after its income tax treatment restatement, the company engaged a new auditing firm. During their initial procedures, the new auditors identified additional material errors related to revenue recognition and expense recognition accounting. In April 2011, the company restated its financial statements for 2008 and 2009 to correct material misstatements of its revenue and expenses for those years The company's improper accounting practices and internal controls deficiencies resulted in filing periodic reports with the SEC for the years 2006 through 2009 which materially overstated its income and understated its expenses. The company received a cease and desist order from committing or causing any violations and any future of sections of the Exchange Act. Within thirty days of the entry of the order, the company shall pay a civil money penalty in the amount of $200,000 to the United States Treasury.

- ***A major bank submitted an offer of settlement that the SEC has determined it will accept as part of an order instituting cease and desist proceedings regarding internal control problems.*** The internal control issues resulted in a material misstatement of the bank's results in the first quarter of 2012. Within most large financial institutions and investment firms, valuation control units serve as an essential internal control by helping to ensure that traders and other market professionals record accurate valuations for trading positions. Valuation control units must be sufficiently independent from the trading desks, and clear and effective written policies are necessary in order to guard against the risk that a company's investment assets will be improperly valued and its public filings misstated.

The valuation unit for this bank was unequipped to cope with the increase in size and complexity of the matters presented to them and therefore did not function as an effective internal control. The unit was understaffed, insufficiently supervised, and did not adequately document its actual price-testing policies. Moreover, the actual price-testing methodology employed was subjective and insufficiently independent from the traders, enabling the traders to improperly influence the process. The release also described communication breakdowns including those between senior management and the audit committee, a necessary function in a properly functioning internal control environment. In response to the SEC's investigation, the bank provided substantial cooperation to the SEC staff. The bank has also voluntarily undertaken a comprehensive program of remediation to address, among other things, the internal control deficiencies that are the subject of this proceeding. Most notably, the bank has substantially strengthened its valuation control function to ensure that price verification procedures are conducted with the appropriate degree of independence and supervision.

The Q3 2013 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in Q3 2013 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
Defalcation	Thefts of funds and assets
Options Backdating	Intentional misdating of stock option awards

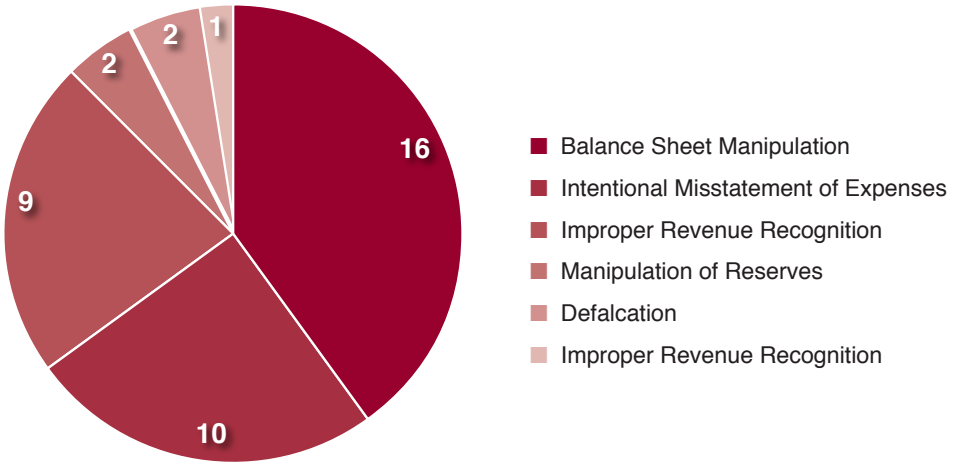
DEPLOYING THE FULL ENFORCEMENT ARSENAL

"When investors realize there is a strong and effective cop on the beat, they have greater confidence and are more willing to participate in the markets. The tap for capital opens more widely, providing more funding for our nation's businesses. And with access to new capital, businesses can hire more workers, develop new products, and find new ways to deliver greater returns to shareholders."

Chairman Mary Jo White
U.S. Securities and Exchange Commission
Council of Institutional Investors Fall Conference
Chicago, IL
September 26, 2013

The following chart provides the results of our financial reporting issue analysis for the Q3 2013 AAERs.

Q3 2013 AAERs by Financial Reporting Issue



AAERs reported by Financial Reporting Issue for Quarter Ended September 30, 2013:

40

Notable Q3 2013 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.

In the Matter of JAMES M. SCHNEIDER, CPA Release No. 3470, Administrative Proceeding File No. 3-14171

If you want to better understand what it means to be suspended from "appearing or practicing before the Commission as an accountant" under Rule 102(e)(3)(i), then please read the SEC decision on a motion by James M. Schneider, a CPA and the former CFO of Dell, Inc.

For background, the SEC instituted civil proceedings in July 2010 against Dell and certain of its executives, including Mr. Schneider, in the United States District Court for the District of Columbia. Among other violations, the SEC's complaint alleged that Dell, Schneider, and other Dell executives engaged in fraud by failing to disclose material information and using an accounting scheme to create the false appearance that the company was consistently meeting earnings targets and reducing its operating expenses. As part of the resolution for the case, Mr. Schneider agreed to a Rule 102(e) suspension, barring him from appearing or practicing before the SEC as an accountant for five years, after which he may apply for reinstatement.

Prior to accepting the Rule 102(e) sanctions, Mr. Schneider was serving as a director and audit committee member at three publicly held companies. Mr. Schneider subsequently resigned from two of those companies, but he continued to serve as a director and audit committee chair at one public registrant. However, the SEC subsequently notified Mr. Schneider that he was violating the terms of his Rule 102(e) order by serving on said audit committee.

Thereafter, Mr. Schneider resigned from the audit committee and filed a motion with the SEC seeking to clarify and narrow the suspension order "to prevent the existing order from being construed by the Staff of the Commission as barring activities that are outside the scope of Rule 102(e)(3)(i)." In essence, per Mr. Schneider's motion takes the position that the staff was misinterpreting the language in Rule 102(e) and that the SEC needed to remedy the Staff's unsupported actions.

In particular, Mr. Schneider's motion requested the SEC to "issue an order clarifying that the Rule 102(e) Order does not prohibit him from accepting non-accountant positions, such as positions on an audit committee or as a non-accountant CFO." Indeed, Mr. Schneider's position was that a Rule 102(e) suspension would be satisfied as long as he did not serve in the role of principal accounting officer.

The SEC denied Mr. Schneider's motion. In the denial, the SEC provided relevant commentary regarding the proper interpretation of what it means to be suspended from "appearing or practicing before the Commission as an accountant".

Notably, the SEC concluded that Mr. Schneider's focus on job titles misses the proper emphasis of Rule 102(e) which should be placed on the substance of the tasks and responsibilities that are involved with any position, regardless of title. Rule 102(e) defines "practicing before the Commission" as including, but not limited to, "[t]ransacting any business with the Commission" and "[t]he preparation of any statement, opinion or other paper by any . . . accountant . . . filed with the Commission in any registration statement, notification, application, report or other document with the consent of such . . . accountant." ***Determining whether a particular position fits within this definition involves a "fact-specific inquiry" into the conduct involved when serving in such a position.***

Notably, the SEC concluded that Mr. Schneider's focus on job titles misses the proper emphasis of Rule 102(e) which should be placed on the substance of the tasks and responsibilities that are involved with any position, regardless of title.

For emphasis, the SEC cited a recent U.S. district court decision which described someone who is appearing or practicing before the SEC as an accountant to include persons who "participate[d] in the preparation of' financial statements filed with the Commission by, for example, 'creat[ing],' 'compil[ing]' or 'edit[ing]' information or data incorporated into those documents and consenting to their incorporation."

Additionally, the SEC concluded that Mr. Schneider had fair notice that the Rule 102(e) order would prohibit him from serving on a public company's audit committee or as CFO based on the definition stated above. The SEC also stated that such a prohibition is consistent with Rule 102(e)'s remedial purpose of ensuring that accountants, "on whom the Commission relies heavily in the performance of its statutory duties, perform their tasks diligently and with a reasonable degree of competence."

The Schneider AAER makes certain that the reference to an accountant in Rule 102(e) is not a limiting status or title but rather an expansive one that encompasses all forms of assisting in the function for the delivery of financial information that is filed with the SEC and relied upon by the investing public.

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Securities and Exchange Commission v. China Media Express Holdings, Inc. and Zheng Cheng, Civil Action No. 1:13-cv-00927 (D.D.C.) Litigation Release No. 22731 / June 20, 2013, Accounting and Auditing Enforcement Release No. 3479 / June 20, 2013

The SEC charged China Media Express Holdings, Inc. ("CMEH"), an entity that purportedly operates a television advertising network on inter-city and airport express buses in the People's Republic of China, with fraudulently misleading investors about its financial condition by falsifying financial results including reporting cash balances that were materially overstated. In 2010, the cash overstatement exceeded $150 million.

The SEC alleges that CMEH began falsely reporting significant increases in its business operations, financial condition, and profits almost immediately upon becoming a publicly-traded company through a reverse merger in October 2009. In addition to grossly overstating its cash balances, CMEH also falsely stated in public filings and press releases that two multi-national corporations were its advertising clients when, in fact, they were not.

Per the complaint, after suspicions of fraud were raised by CMEH's external auditor and an internal investigation ensued, CMEH's CEO allegedly attempted to bribe a senior accountant assigned to the forensic accounting team with a $1.5 million payment to "assist with the investigation". The forensic accountant promptly reported the bribe to superiors and to legal counsel leading the internal investigation. The fraud was revealed soon thereafter.

Little has been reported on how the fraud was orchestrated, however based on what's been reported, it appears that it may have involved setting up false clients, recording revenue and accounts receivable that were, in all likelihood, reflected as cash collections on the books and records to avoid detection through accounts receivable audit confirmations. This possible approach, however, would require the fabrication of the cash reconciliation and control over the bank confirmation process. In fact, a very similar situation exists at another Chinese company that according to press reports imploded after reporting fabricated results and overstating bank balances.

While many believe problems like the alleged fraud at CMEH are symptomatic of Chinese reverse mergers listed on the U.S. exchanges, a recent academic paper proves this belief to be false. According to the current draft of an academic paper "Shell Games: Are Chinese Reverse Merger Firms Inherently Toxic?" by Professors Charles M. Lee, Kevin K. Li, and Ran Zhang, key findings include:

> *"While legitimate issues remain with the structural integrity of corporate governance and internal controls of Chinese firms, our evidence indicates that the current Sino-phobic reaction to CRMs [Chinese reverse mergers] may be overblown." And*
>
> *"In sum, recent bad press notwithstanding, we find virtually no evidence that Chinese RMs [reverse mergers] are systematically more problematic than other comparable firms that are already listed on the same exchange."*

In summation, while the media and others have trumpeted problems with Chinese companies, as with many other things, it's important to get the full set of facts before forming a point of view.

While many believe problems like the alleged fraud at CMEH are symptomatic of Chinese reverse mergers listed on the U.S. exchanges, a recent academic paper proves this belief to be false.

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 their classification. That said, comparisons of the number of AAERs between periods may be a useful gauge of the SEC's activities.

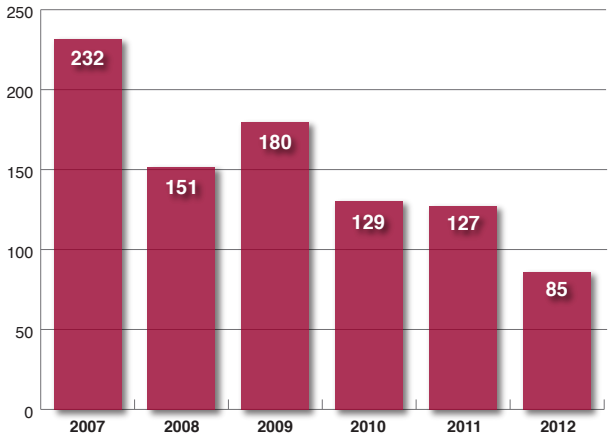
AAERs reported for Year Ended December 31, 2012:

85

AAERs reported for the Nine Months Ended September 30, 2013:

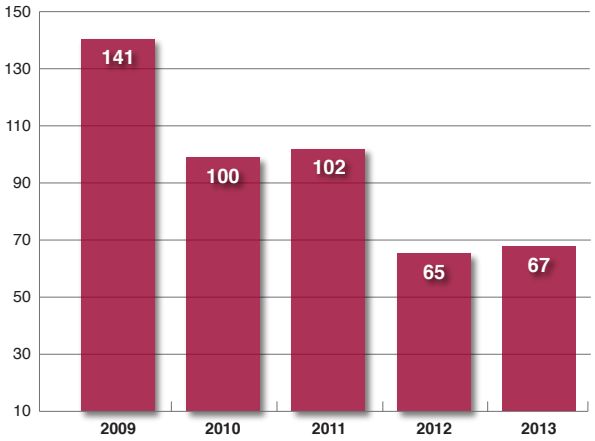
67

AAERs
For the Years Ended December 31,



For the year ended December 31, 2012, the SEC issued 85 AAERs, remarkably the lowest number of AAERs reported over the last six years. For comparison, the average rate for the periods 2007 through 2012 was approximately 151 releases, with the greatest number of releases issued in 2007.

AAERs
For the Nine Months Ended September 30,



When analyzing the AAER population issued during the first nine months for the years 2009 through 2013, the 2013 results reflect slight increase over 2012 and a material drop from prior years, as reflected in this graph. However, the Q3 2013 volume of 33 AAERs is equal to almost the entire volume of the first half of 2013. If matched in Q4 2013, this rate would result in a material increase for the year and a return to levels experienced in 2010 and 2011.

SEC NEWS: SPECIAL ANNOUNCEMENTS AND UPDATES

During the quarter ended Sept. 30, 2013, the SEC announced several newsworthy items including the major developments described below.

SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis

The SEC announced three new initiatives that will build on its Division of Enforcement's ongoing efforts to concentrate resources on high-risk areas of the market and bring cutting-edge technology and analytical capacity to bear in its investigations. The initiatives are:

The Financial Reporting and Audit Task Force, dedicated to detecting fraudulent or improper financial reporting, whose work will enhance the Division's ongoing enforcement efforts related to accounting and disclosure fraud.

The Microcap Fraud Task Force, targeting abusive trading and fraudulent conduct in securities issued by microcap companies, especially those that do not regularly publicly report their financial results.

The Center for Risk and Quantitative Analytics, employing quantitative data and analysis to profile high-risk behaviors and transactions and support initiatives to detect misconduct, increasing the Division's ability to investigate and prevent conduct that harms investors.

"These initiatives build on the Division's unmatched record of achievement and signal our increasingly proactive approach to identifying fraud. By directing resources, skill, and experience to high-impact areas, we will increase the potential for uncovering financial statement and microcap fraud early and bring more cases aimed at deterring these types of unlawful activity," said Andrew J. Ceresney, Co-Director of the Division of Enforcement.

"The best investigative ideas usually come from the grass roots - staff in the field observing the market first-hand," said George S. Canellos, Co-Director of the Division of Enforcement. "A key objective of the Center for Risk and Quantitative Analytics will be to assist these staff members, bringing them analytical techniques and computing capacity with special expertise in data mining, and help them translate their valuable ideas into timely, thoughtful, and targeted investigations of national scope." ■

SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund

The SEC announced that three whistleblowers have been awarded more than $25,000 combined for tips and information they provided to help the SEC and Justice Department stop a sham hedge fund.

This is the first installment of anticipated payments to the whistleblowers as additional assets are recovered from the purported hedge fund manager. The whistleblowers are expected to ultimately receive approximately $125,000 in total.

The SEC issued an order earlier this summer rewarding each of the three whistleblowers with five percent of the money that the SEC ultimately collects from its enforcement action against Locust Offshore Management and its CEO Andrey C. Hicks. In cases where there are related criminal proceedings in which money is collected by another regulator, a provision in the whistleblower rules allows whistleblowers to then additionally apply for an award based off the other regulator's collections in what qualifies as a "related action." The SEC subsequently approved five percent payouts to each whistleblower for money collected in the related criminal action.

Hicks pled guilty on Dec. 12, 2012 to five counts of wire fraud and consented to the forfeiture of his interest in property previously seized by the Justice Department. He was sentenced to forty months in prison. Approximately $170,000 has been administratively forfeited in the criminal proceeding, money that is deemed collected for purposes of issuing whistleblower awards. Therefore, the three whistleblowers will now receive $8,505 each. Additional payments can be made to these whistleblowers upon forfeiture of the additional assets that have been seized.

The aggregate value of assets seized from Hicks is estimated to be approximately $845,000, and the whistleblowers are expected to ultimately receive fifteen percent of this amount for a combined total of approximately $125,000.

The SEC's order does not identify the whistleblowers, whose confidentiality is protected under the SEC's whistleblower program. The order states that two of the whistleblowers provided information that prompted the SEC to open an investigation and stop the scheme before more investors were harmed. The third whistleblower identified key witnesses and confirmed information the other two whistleblowers provided.

The SEC's whistleblower program is authorized under the law to reward individuals who offer high-quality, original information that leads to an SEC enforcement action in which more than $1 million in sanctions is ordered. ■

SEC Proposes Rules for Pay Ratio Disclosure

The Securities and Exchange Commission voted 3-2 to propose a new rule that would require public companies to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees.

The new rule, required under the Dodd-Frank Act, would not prescribe a specific methodology for companies to use in calculating a "pay ratio." Instead, companies would have the flexibility to determine the median annual total compensation of its employees in a way that best suits its particular circumstances.

"This proposal would provide companies significant flexibility in complying with the disclosure requirement while still fulfilling the statutory mandate," said SEC Chair Mary Jo White. "We are very interested in receiving comments on the proposed approach and the flexibility it affords."

The proposal will have a 60-day public comment period following its publication in the Federal Register. ■

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ABOUT Floyd Advisory
Floyd Advisory is an independent business consulting and forensic accounting firm with offices in Boston and New York City, providing services relating to: financial reporting problems, fraud investigations, SEC reporting issues, white collar defense matters, post-acquisition disputes, business damages, financial and valuation analyses.

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