Floyd Advisory

Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended March 31, 2018

Q1 REPORT 2018

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Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the quarter ended March 31, 2018.

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
APRIL 2018

Highlights:

- **The United States Department of Justice indicted three former PCAOB employees related to the unauthorized disclosure of confidential PCAOB audit firm inspection information. The alleged scheme involved sharing the information with a Big Four firm so that it would be apprised of the PCAOB's anticipated audit inspections. In many ways, the alleged improper use of the confidential PCAOB information resembled a classic insider trading fraudulent scheme.**

- **Only sixteen SEC Enforcement actions are designated as AAERs in Q1 2018. This number represents the 4th lowest quarterly amount in the publicly available eighteen years of published AAERs. Our Special Feature provides a "pro forma" assessment of this result, and indicates an even lower number of actions relating solely to the efforts of the SEC Enforcement Division.**

- **Finally, we report on the Maxwell Technologies, Inc. case in our Recommended Reading section. The case involves allegations of an accounting fraud scheme to improperly and prematurely recognize millions of dollars in revenue. Of significance, the allegations raise clear indicia of fraudulent acts, yet the punishment appears rather lenient.**

Our Process and Methodology

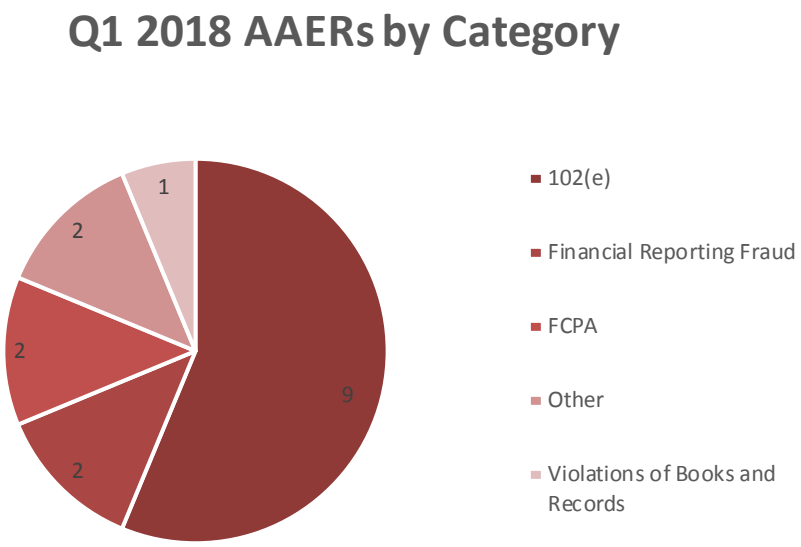
The SEC identifies and discloses accounting- and auditing-related enforcement actions from within its population of civil lawsuits brought in federal court, and its notices and orders concerning the institution and/or settlement of administrative proceedings as Accounting and Auditing Enforcement Releases ("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 (i.e., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC, Violations of Books and Records, and Other), and classifications of the financial reporting issues involved (e.g., Improper Revenue Recognition, Manipulation of Reserves, Intentional Misstatement of Expenses, Balance Sheet Manipulation and Errors, Options Backdating, and Defalcations). Do note, when a release included more than one allegation, admission, or violation, we placed the release into the category which represented the most significant issue. For our summary of financial reporting issues, we recorded each accounting problem identified as a separate item. Based on this process and methodology, we prepared a database of the key facts in each release.

The Q1 2018 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed sixteen AAERs during Q1 2018, with SEC Rule 102(e) actions representing 56% of the total releases.



"When we take action — whether through rulemaking, inspections, or enforcement — behavior changes, and investors, industry participants, and the public are likely to support our work. Why? Because we exercise our regulatory powers with a laser focus on the Commission's mission, which requires, among other things, integrity, energy, expertise, and good judgment. Note, these are uniquely human characteristics."

Chairman Jay Clayton
Washington D.C.
Feb. 23, 2018

Opening Remarks at the "SEC Speaks" Conference

While our categorical breakdown is analytically useful, a closer look at specific cases for each category provides a clearer understanding of the SEC's areas of focus as an enforcement agency.

Rule 102(e) Actions

Rule 102(e) actions involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC. For accountants, the standards under which one may be penalized with a Rule 102(e) action include reckless, as well

as negligent conduct, defined as a single instance of highly unreasonable conduct that violates professional standards or repeated instances of unreasonable conduct resulting in a violation of professional standards and indicating a lack of competence.

Ten individuals and three firms received Rule 102(e) sanctions. Three of these individuals and all three firms neither admitted nor denied the charges. The Commission did not indicate whether the remaining seven individuals either admitted or denied the charges.

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

- ***The SEC ordered public administrative and cease-and-desist proceedings for six Certified Public Accountants ("CPAs") related allegations of disclosing and using confidential Public Company Accounting Oversight Board ("PCAOB") information.*** As described in two related AAERs, a former PCAOB associate director, who later became a partner at a Big Four accounting firm, shared confidential information. Between 2015 and 2017, the firm actively recruited PCAOB employees and received detailed information regarding upcoming audit client work paper inspections by the PCAOB. The firm allegedly used the lists to prepare for the PCAOB's planned inspections. All six CPAs involved have been called to appear in front of an Administrative Law Judge for public administrative and cease-and-desist proceedings to answer questions and provide further evidence. Five of the six were charged in Manhattan Federal Court, and the sixth pled guilty and is cooperating with the government.

- ***The SEC sanctioned two public accounting firms for their reliance on the work of foreign audit firms lacking formal PCAOB registrations.*** The cases involve the audits for one registrant. Two firms are involved due to a change in auditors, yet the same problems arose with both firms. The registrant is incorporated in Canada with principal executive offices in South Africa. The SEC claims that for at least six years, the issuer's auditors utilized the work of audit firms that did not follow the formal registration process with the PCAOB, thereby violating PCAOB standards. As a result, the audit firms responsible for the issuer's audits were censured, issued cease and desist orders from committing any future violations, and face civil penalties. The unregistered firms received fines for disgorgement and prejudgment interest.

- ***The SEC sanctioned a CPA and his public accounting firm for aiding and abetting in the creation of seven fraudulent shell companies.*** The shell companies were allegedly used to issue shares to the public and then to sell the companies in reverse mergers or other changes in control. Per the allegations, the CPA and his firm failed to implement reasonable client-acceptance and continuance procedures and demonstrate professional skepticism regarding the control persons related to the seven shell companies. The firm and the CPA also failed to properly audit related-party transactions between the control persons and the shell companies or maintain sufficient audit documentation.

"International organizations, of course, play an important role in fostering effective regulation and supervision. It is a role to which I am committed. These groups provide a framework within which countries assist one another in enforcement and oversight efforts. Many of the Commission's investigation and enforcement efforts have an international component, so such cooperation is essential."

Commissioner Hester M. Peirce
San Antonio, TX
March 19, 2018

"Remarks at the 2018 Mutual Funds and Investment Management Conference"

- ***The SEC suspended a CPA following a criminal conviction for fraudulently inflating financial performance metrics used for real estate investment trusts (REITs) reporting.*** The SEC alleged that the Chief Financial Officer ("CFO") of a publicly traded company, with the help of the company's Chief Accounting Officer, manipulated the Adjusted Funds from Operations metric in its public reports for the fiscal quarter ending in June 2014. A jury found the CFO guilty of criminal conduct. In addition, the CFO, who is also a CPA, is suspended from appearing or practicing as an accountant before the SEC."

- ***The SEC suspended a CPA for failing to comply with relevant PCAOB standards.*** The CPA allegedly failed to comply with the relevant PCAOB standards with respect to the performance of proper engagement quality reviews for audits and interim reviews of seven issuers. According to the claim, this respondent repeatedly failed to comply with relevant documentation requirements and, in many instances, backdated and falsified audit and review documents. The CPA is suspended from appearing or practicing as an accountant before the SEC.

- ***The SEC suspended a CPA related to allegations of insider trading.*** According to the SEC, the CPA engaged in insider trading while working at a company as a consultant responsible for the company's accounting. According to the allegations, the CPA acted on information regarding an acquisition received a month prior to when it was announced to the public. Upon receipt of this material non-public information, the CPA purchased shares in the company. The announcement of the acquisition offer caused a 428% increase in the company's share price, at which point the CPA sold the shares for a profit. The CPA is suspended from appearing or practicing before the SEC as an accountant and ordered to pay disgorgement, prejudgment interest, and civil penalties.

"And Congress or the Commission should also move quickly to make sure that, when one member of senior management learns material nonpublic information, no member of the team is trading in the company's stock. We may also need to ask ourselves, more fundamentally, whether the insider-trading law we have is adequate to meet these new challenges."

Commissioner Robert J. Jackson, Jr.
New Orleans, LA
March 15, 2018

"Corporate Governance: On the Front Lines of America's Cyber War"

FCPA Violations

There were two FCPA-related releases in Q1 2018 resulting in $1.45 million in civil penalties. The two releases from this quarter are:

- ***An international holding company headquartered in Israel was fined $500K and issued a cease and desist order following alleged violations that involved millions of dollars in improper payments.*** According to the SEC, during a five-year period, the public holding company, both directly and through an indirect subsidiary, paid millions of dollars to third-party offshore consultants and sales agents purportedly for real estate development services in Romania and the United States. Per the claim, there was no evidence supporting that services were in fact provided by sales agents or consultants and the company and the subsidiary failed to properly record those payments in a way that fairly reflected their nature. The company and the subsidiary also allegedly failed to maintain internal accounting controls sufficient to limit the use of company funds to legitimate corporate functions or record transactions

as necessary to maintain accountability for assets. The firm self-reported this information to the United States and Romania and cooperated fully with the SEC's investigation.

- ***A Canadian gold mining company was fined $950K and issued a cease and desist order for violating the books and records and internal accounting controls provisions of the FCPA.*** The company operated gold mines in two African countries and, according to the SEC, for a five-year period, did not maintain internal accounting controls to reasonably assure that transactions were executed in accordance with management authorization and contracts were awarded following the mining company's bidding and tendering procedures. According to the release, the company provided no reasonable assurances that transactions, often involving government interactions, were consistent with their stated purpose or the prohibition against making improper payments to government officials. Per the claim, the company failed to accurately and fairly describe petty cash payments to consultants in its books and records. The company also allegedly failed to keep adequate internal accounting controls around awarding a large logistics contract to a company preferred by government officials without proper due diligence and without following its own bidding and tendering procedures.

Financial Reporting Fraud

We categorized two AAERs as financial reporting fraud during the quarter. Our review of the Maxwell Technologies, Inc. release can be found in detail in our "Recommended Reading" section. A summary of the second release is as follows:

- ***The SEC charged three respondents in connection with an alleged fraudulent scheme to create and sell seven public shell companies.*** According to the SEC, the respondents created publicly-traded shell companies by filing false and misleading registration statements and periodic reports, creating fake business plans, and appointing officers and directors and fake initial shareholders who had no connection to the shell companies. The respondents allegedly concealed their control of the companies and the companies' lack of any actual or intended business. Also, according to the SEC, the respondents conducted initial public offerings of certain shell companies and, while continuing to control the companies' shares, the respondents subsequently sold certain shell companies at a profit of more than $1.8 million. The three respondents have agreed to pay disgorgement and prejudgment interest totaling almost $1.7 million, disgorgement and prejudgment interest totaling more than $300,000, and disgorgement and prejudgment interest totaling more than $100,000. One of the three respondents is a CPA, and received a Rule 102 (e) suspension that is described earlier in our report.

"We have a foundation of exceptional design and resilience, with the '33 and '34 Acts being the bedrock components. But, in comparison to companies that operate in the financial markets, the asset side of our balance sheet is far from extensive — the Commission has over 4,500 people and an annualized budget of $1.6 billion in fiscal year 2018..."

Chairman Jay Clayton
Washington D.C.
Feb. 23, 2018

Opening Remarks at the "SEC Speaks" Conference

Violations of Books and Records

This quarter we categorized one AAER 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.

- ***A pharmaceutical company and its former CFO and its former Controller are charged with reporting and accounting violations.*** The company admitted material weaknesses in its internal controls over the company's financial reporting in 2014. According to the SEC, in a 2016 restatement, the company's financials for 2014 overstated net revenue by 7% and income from continuing operations by 136%. Per the claim, the company's material weaknesses were present over multiple reporting periods. The company and two former employees were enjoined from controlling any person liable for violations of, the financial reporting, books and records, and internal accounting control provisions of the securities laws. The two former employees each faced a civil penalty.

"My colleagues in the Division of Enforcement do invaluable work every day protecting investors. But there are limits to what they can do—especially today, when the SEC's budget is frozen and fraudsters are finding new ways to harm investors. Our enforcement efforts are straining against the limits of the SEC's resources. And recent judicial developments have made the job of our enforcement staff harder than ever before."

Commissioner Robert J. Jackson, Jr.
New York, NY
Feb. 26, 2018

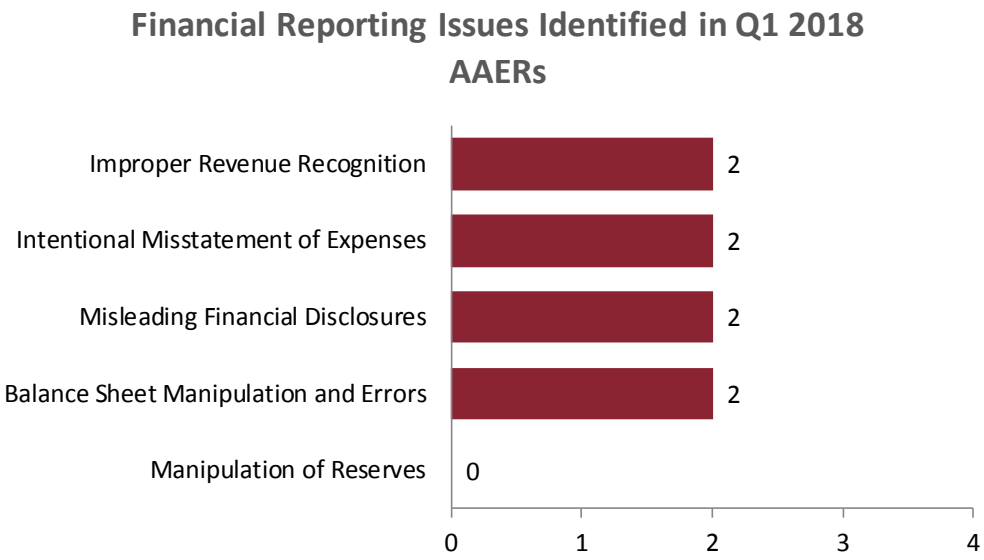
CECP CEO Investor Forum: "Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration"

The Q1 2018 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in Q1 2018 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
Intentional Misstatement of Expenses	Deceptive misclassifications and misstatements of expenses
Manipulation of Reserves	Improperly created, maintained, or released reserves and other falsified accruals
Misleading Financial Disclosures	Other financial disclosure errors, omissions, or otherwise misleading representations
Balance Sheet Manipulation and Errors	Misstatement and misrepresentation of account balances and the recording of transactions inconsistent with their substance

Importantly, as we described in the "Our Process and Methodology" section, we record each accounting problem identified in an AAER as a separate item. Therefore, actions which involve improper revenue recognition, intentional misstatement of expenses, and manipulation of reserves may also have a balance sheet impact. For this reason, we move the Balance Sheet Manipulation and Errors category to the bottom of our issue ranking. The chart below illustrates the frequency of financial reporting issues by category among all AAERs issued during Q1 2018. Six of Q1 2018's sixteen releases yielded the following eight financial reporting issues.



While it is possible for one release to contain several financial reporting issues, we also observe instances where releases do not contain any of the financial reporting issues discussed above. The ten Q1 2018 releases that did not contain a financial reporting issue are described below:

- Four releases dealt with public registrant audit work performed by firms not registered with the PCAOB,
- three releases documented the creation of fraudulent shell companies,
- two releases related to the sharing of confidential PCAOB information with a Big Four firm, and
- one release discussed an instance of insider trading.

"Finally, part of the solution must come from industry professionals and gatekeepers. This includes lawyers, accountants, exchanges, investment advisors, broker-dealers, and others. Gatekeepers are on the front lines. ... All gatekeepers need to remember that there are real people behind each account number, who are saving for college, retirement, or any number of financial goals. Gatekeepers should be part of the solution, not part of the problem."

Commissioner Kara M. Stein
Washington D.C.
Feb. 23, 2018

Remarks at SEC Speaks: "Increasing Product Complexity: What's at Stake?"

Special Feature

Where Have All the AAERs Gone?

If published on April 1st, the Special Feature headline could have read, "SEC Enforcement Division No Longer Needed Based on Q1 2018 Activity." However, it is not April Fool's day, and the very low level of AAER activity in the quarter is a reality.

As described above, sixteen actions are designated as AAERs in Q1 2018. Before analyzing these actions, it's important to note that it reflects the 4th lowest quarterly tally when considering the prior eighteen years of published AAERs. The only quarters with lower activity occurred in Q2 2012 (14), Q1 2013 (15), and Q2 2014 (14).

Notably, in the spirit of releasing "pro forma" results that are meaningful for the users of our reports, a closer look into the Q1 activity indicates an even lower number or releases arose from independent and labor-intensive efforts by the Enforcement division.

In fact, within the sixteen releases:

- four releases relate to firms in Zimbabwe not adhering to PCAOB registration rules; score those for the PCAOB,
- two relate to the sentencing of a former registrant's CFO following a criminal trial; score those for the United States Department of Justice, and
- two relate to the indictments of three former PCAOB employees for the theft of confidential information; score those for the PCAOB and DOJ.

After considering these adjustments, there are eight AAERs remaining in the quarter, but there are more "pro forma" adjustments still to be made.

First, among the remaining eight, there is an FCPA case that is self-reported and the registrant is actually rewarded for its cooperation, thereby likely making the Enforcement Division's efforts quite manageable on this case.

Next, two matters arise due to restatements, thus the registrant's volunteered admissions to internal controls and other books and records violations. Similarly, the division's efforts were fairly well defined and limited in these two instances.

With those adjustments, the net "pro forma" result for AAER activity in Q1 2018 is limited to three events: a micro-cap related group of companies with a fraud that generated three AAERs, an FCPA case, and an insider trading case.

"Because of the limited scope of the SEC's resources, investors themselves have typically borne a large share of the responsibility for policing the markets and rooting out misconduct. Over the years, Congress, the Supreme Court, and former SEC Commissioners have recognized the importance of private suits in helping to protect investors and deter wrongdoing."

Rick Fleming
Investor Advocate
Washington D.C.
Feb. 24, 2018

PLI's The SEC Speaks in 2018:
"Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders"

Therefore, the "pro forma" tally for AAERs for Q1 2018 (even when scoring three releases for the micro-cap fraud event) is five. For comparison, there are over 1,300 employees in the Enforcement division.

Why is the result so low? Several theories arise such as leadership transitions, change in enforcement philosophy, improved financial reporting and even possibly, greater integrity among those involved in the capital markets, among others. Importantly, if the result is the new normal, then maybe we may someday see the April 1st headline, and enforcement will be a thing of the past.

Notable Q1 2018 AAER for "Recommended Reading"

While reviewing all of the SEC's AAERs would prove insightful, certain releases present information that is especially worthy of further review and analysis by those involved with financial reporting matters. We deem these particular releases as earning the distinction of Recommended Reading for our clients.

For this quarter, we selected the following AAER to highlight. This case involves charges brought to light by a whistleblower letter sparking an internal investigation leading to an announcement that certain of the company's financial statements were materially misstated and not reliable. According to the AAER, the company demonstrated having insufficient internal accounting controls to identify and properly account for its revenue over multiple years.

Accounting and Auditing Enforcement Release No. 3932 / March 27, 2018, Administrative Proceeding File No. 3-118408, In the Matter of Maxwell Technologies, Inc., Van M. Andrews, David J. Schramm, and James W. DeWitt, Jr., CPA, Respondent.

The SEC recently settled civil fraud allegations against Maxwell Technologies, Inc. ("Maxwell"), its former CEO, Corporate Controller, and Senior Vice President of Sales and Marketing (the "parties") related to improper revenue recognition.

Notably, based on the facts and allegations in the SEC's AAER, fraudulent conduct to produce false financial results to investors without question occurred at Maxwell. In contrast though, the SEC settlement involves only cease and desist orders against all involved, an officer and director bar for five years against the former the SVP of Sales and Marketing, nominal fines, and other remedial actions for Maxwell.

"In addition, investors have remedies that may not be available to regulators, the most important of which is the ability to seek full restitution of their losses instead of merely disgorging the bad actor's ill-gotten gains. Resource constraints can also make regulators pick and choose among cases, which means that the government may decline to pursue many viable cases. In short, our regulatory framework assumes that investors themselves will serve an important role in policing the markets."

Rick Fleming
Investor Advocate
Washington D.C.
Feb. 24, 2018

PLI's The SEC Speaks in 2018: "Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders

Below you will find an overview of select facts and allegations from the AAER that will highlight the elements of the alleged fraudulent scheme and raise fair discussion points regarding whether the "punishment" seems sufficient in light of the alleged conduct. Per the SEC, from December 2011 through January 2013, Maxwell, a California-based company that develops, manufactures, and markets energy storage and power delivery products, engaged in an alleged accounting fraud scheme to improperly and prematurely recognize over $19 million in revenue.

Based on the AAER, there are two major categories for the problems at Maxwell. The first involves an overly aggressive and unethical sales department. The second is, at least, the failure of the finance and accounting function to maintain adequate controls to detect the improper sales conduct, if not actual knowledge of the scheme.

The sales department allegedly used several improper tactics to prematurely record revenue, including:

- customer side deals with contingent payment terms and full rights of return;
- channel stuffing;
- extending payment terms;
- falsifying purchase orders ("POs") and third-party confirmations; and
- instructing certain distributors to order product they neither wanted nor needed at quarter-end.

While the sales department was busy improperly creating false revenue, the accounting department repeatedly allowed customer credit limits to be increased with little to no support and missed what appear to be other obvious signs of problems that will be discussed below. Needless to say, the sales department's deceptive acts complicated the job of the accounting department, but do not absolve Maxwell of its responsibility to maintain adequate controls, something it failed to do.

Importantly, senior management was aware the company was experiencing large and growing sales volumes, the majority of which was recorded during the last days of each quarter, as well as the aging of certain account receivable balances; the combination of these factors providing a strong indication that something was amiss with the sales being reported or the financial condition of its customers. In addition, according to the AAER, the majority of the problem sales were to distributors, and one distributor in particular, adding yet another reason to be suspicious that a problem was brewing.

Per the SEC, in January 2013, after a whistleblower contacted the chairmen of Maxwell's board of directors, Maxwell's audit committee initiated an internal investigation. As a result of that investigation, in March 2013, Maxwell announced that its previously issued financial statements on Form 10-K for 2011 and all quarterly reports on Forms 10-Q in 2011 and 2012 could not be relied upon. Maxwell also disclosed material weaknesses in its internal controls over financial reporting due to "errors" it discovered in the "timing of recognition of revenue from sales to certain distributors."

In August 2013, Maxwell filed a restatement of the 2011 Form 10-K and Forms 10-Q for the first three quarters of 2012, turning net income into net losses for fiscal year-end 2011 and certain quarters in 2012.

"...the Supreme Court has said for years that policing corporate wrongdoing is a team effort. ... For example, in 2016, roughly sixty cents of every dollar returned to investors in corporate-fraud cases came through private rather than SEC settlements. And giving investors their day in court is even more important when the stakes are highest—such as in the wake of a significant corporate fraud."

Commissioner Robert J. Jackson, Jr.
New York, NY
Feb. 26, 2018

CECP CEO Investor Forum:
"Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration"

Of note, and for comparison to the SEC's specific allegations described below, Maxwell's revenue recognition policy, which complies with Generally Accepted Accounting Principles, is:

> Product revenue is recognized when all of the following criteria are met: (1) **persuasive evidence of an arrangement exists** (upon contract signing or receipt of an authorized purchase order from a customer); (2) **title passes to the customer** at either shipment from our facilities or receipt at the customer facility, depending on shipping terms; (3) **price is deemed fixed or determinable** and free of contingencies or significant uncertainties; and (4) **collectability is reasonably assured**. Customer purchase orders and/or contracts are generally used to determine the existence of an arrangement. Shipping documents are used to verify product delivery. We assess whether a price is fixed or determinable based upon the payment terms associated with the transaction. We assess the collectability of accounts receivable based primarily upon creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

The following items are summarized from the AAER and represent some of the more egregious allegations made by the SEC against the parties.

Customer Cancellation leads to Manipulation of a Distributor Relationship

Maxwell's problems appear to begin when a European customer canceled an order in the fourth quarter of 2011, thereby forcing Maxwell to incur sales cancellations and creating a $3.7 million revenue shortfall at year end. Per the SEC, Maxwell's "solution" for this problem was to arrange "to have a small, family-run distributor in Europe take possession" of the cancelled product. However, the distributor lacked the ability to pay for the product, so Maxwell agreed that payment would not be required until the distributor collected cash from end customers, after it sold the product. Importantly, the sales amount for this distributor now far exceeded its credit approval. However, without any apparent justification, the finance and accounting department raised the distributor's credit limit.

Deceitful and Fraudulent Acts

As one may expect, the distributor described above sent Maxwell POs describing the sales terms it had agreed to, including that no payment would be due until the products are ultimately sold to end customers. In fact, Maxwell's finance and accounting team identified this as a problem but was informed by the sales department that the POs were flawed and would be corrected.

As part of their year-end audit procedures, Maxwell's auditors selected the transaction for testing and the accounting team advised the sales department that the revised POs were needed as soon as possible. Members of the sales department, apparently acting on their own, requested new POs from the distributor with the contingent sale terms

"Our securities laws – and 80 plus years of practice – assume that securities lawyers, accountants, underwriters, and dealers will act responsibly. It is expected that they will bring expertise, judgment, and a healthy dose of skepticism to their work. Said another way, even when the issue presented is narrow, market professionals are relied upon to bring knowledge of the broad legal framework, accounting rules, and the markets to bear."

Chairman Jay Clayton
Washington D.C.
Jan. 22, 2018

Opening Remarks at the Securities Regulation Institute

removed, and sent a side agreement in a fax to the distributor assuring them of the actual agreed upon terms. Needless to say, the existence of this fax was hidden from the accounting team, and the auditors were provided with a fraudulent PO.

Obvious Warning Signs and Indicia of a Problem

After the premature and improper revenue recognition for year ended December 31, 2011 had been recorded, the sales department turned its focus to 2012 results. Importantly, when revenue recognition is improperly accelerated, the conduct generally results in abnormally lower sales in the period that follows, resulting in a gap that must be filled to meet analyst expectations. This appears to be the situation encountered by Maxwell; and the company apparently turned to the same distributor scheme for a solution.

Notably, these improper actions and improper revenue recognition left a fairly visible accounting trail. For example, due to the delayed and contingent payment terms, the distributor's accounts receivable balance became greater than expected; especially when compared with other customers. Remarkably, the accounting department, who the SEC does not describe as explicitly involved in the scheme, even tracked the distributor's sales to end customers as a means of estimating when Maxwell may collect for its accounts receivable.

Sales to this distributor also rose dramatically during the final two weeks of each quarter; a "red flag" for channel stuffing, which was also visible to the accounting team. Channel stuffing is the practice of moving product to distributors and re-sellers at terms that may not warrant revenue recognition criteria.

In addition, even with visibility to the problems described above, the accounting team continued to increase the distributor credit limit without competently performing necessary due diligence on the entity; allowing the scheme to continue.

Conspiracy to Deceive the Auditors; Again

With the amount and age of the distributor accounts receivables for the third quarter of 2012 growing, the auditors elected to confirm the balances and terms directly with the distributor. Knowing this, the sales department allegedly conspired with the distributor to file a false confirmation response to the auditors, which stated that the sales terms did not contain any contingencies. Similarly, the sales department and distributor conspired to complete another fraudulent confirmation response to the auditors at year-end.

In closing, this is a financial reporting fraud case with evidence of falsifying accounting records, engaging in side letters, overriding internal controls, conspiring to deceive auditors, and other bad acts. Yet, the "punishment" is limited to a civil fraud action brought and settled with the SEC with cease and desist orders against all involved, an officer and director bar for five years against the former the SVP of Sales and Marketing, nominal fines, and other remedial actions for Maxwell. Without understanding more than may be reported in the AAER, the settlement appears difficult to reconcile with the alleged facts and conduct, and especially to other punishments for financial reporting problems.

"I am hopeful that this part of our guidance will lead companies and their counsel to ask themselves whether their existing internal controls are up to the daunting task we face. And I know that all of us at the Commission will be on the lookout for the best practices you'll come up with to prepare your clients for this challenge."

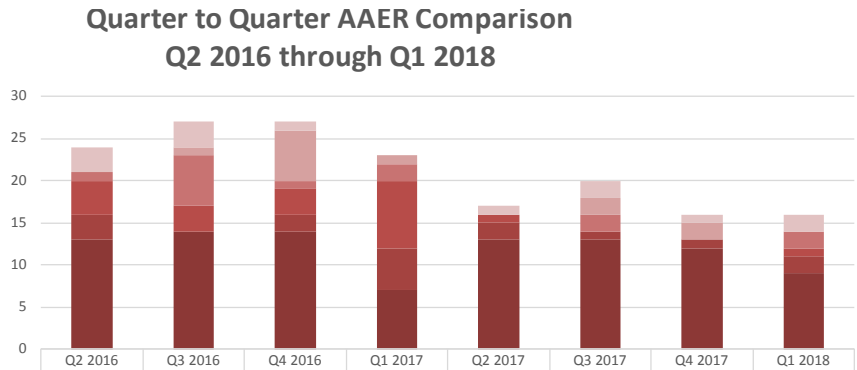
Commissioner Robert J. Jackson, Jr.
New Orleans, LA
March 15, 2018

"Corporate Governance: On the Front Lines of America's Cyber War"

Prior Period Comparison: Quarter over Quarter

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 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.

The following chart maps quarterly totals for each category over the past 8 quarters.



	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Other	3	3	1	0	1	2	1	2
Reinstatement	0	1	6	1	0	2	2	0
FCPA	1	6	1	2	0	2	0	2
Violations of Books and Records	4	3	3	8	1	0	0	1
Financial Reporting Fraud	3	0	2	5	2	1	1	2
102(e)	13	14	14	7	13	13	12	9

Based on this data, we made the following observations:

- Rule 102(e) sanctions continue to be by far the most common category of AAERs, constituting 56% of the total releases during the Q1 2018.
- We observe a downward trend in AAERs per quarter in recent periods. The quarterly average for the twelve months ending Q1 2018 was 17 AAERs, as opposed to a quarterly average of 25 AAERs for the twelve months ending Q1 2017.
- After a minimum of three, and as many as eight AAERs within the Violations of Books and Records category in each quarter from Q2 2016 though Q1 2017, there were only two such releases in the entire twelve months ending Q1 2018.

"...With these resources, we oversee approximately 4,100 exchange-listed public companies, $74 trillion in annual securities trading, and the activities of nearly 27,000 registered market participants. By comparison, in 2016 one large financial institution alone spent more than $9.5 billion on technology and had over 240,000 employees. I will repeat — the SEC has a foundation of exceptional design and resilience, but it is relatively small by many measures."

Chairman Jay Clayton
Washington D.C.
Feb. 23, 2018

Opening Remarks at the "SEC Speaks" Conference

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ACKNOWLEDGEMENT
We wish to acknowledge the valuable contribution to this analysis by Derek J. Miller, Luke J. Anneser, and Alec Hill.

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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, Transaction Analysis and Litigation Services.

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