



*Summary of Accounting and
Auditing Enforcement Releases
for the Quarter Ended
June 30, 2020*

Q 2 R E P O R T 2 0 2 0

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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 June 30, 2020.

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 continue 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 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 2020

Highlights:

- We report on the Penn West Petroleum, Ltd. case in our Recommended Reading section. The case involves allegations of an accounting fraud scheme undertaken to understate publicly reported operating expenses. Notably, the company's internal accounting controls were disregarded by management and failed to prevent or detect the fraud scheme. We offer lessons learned and considerations for audit committees of public registrants to avoid similar problems.
- In our Special Feature section, we analyze the industry and geographical trends of FCPA violations for the five-year period ending June 30, 2020. Notably, three industries, Finance, Insurance, & Real Estate; Pharmaceutical & Medical; and Technology account for nearly half of all FCPA violations (44%) over the previous five years.
- Interestingly, we also observe that China was involved in over 42% of FCPA violations, nearly twice the number of violations involving the second and third most prevalent countries, combined.

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. The disclosed AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all actions that may fit into the definition above.

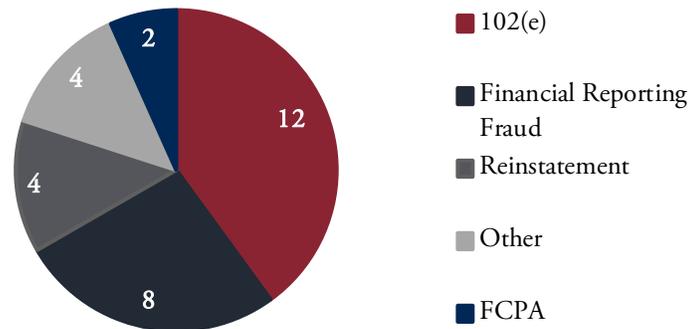
To meet our objective of summarizing the major items reported in the AAERs, we reviewed those releases identified and disclosed by the SEC on its website, www.sec.gov.

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). 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. Based on this process and methodology, we prepared a database of the key facts in each release.

The Q2 2020 AAERs: Summary by Category and Insights from the Releases

The SEC disclosed 30 AAERs during Q2 2020, with SEC Rule 102(e) actions representing 40% of the total releases.

Q2 2020 AAERs by Category



“At any time, and particularly in times of uncertainty, investment professionals should not put their interests ahead of the interests of their clients and customers.”

Chairman Jay Clayton
 April 2, 2020
Investors Remain Front of Mind at the SEC: Approach to Allocation of Resources, Oversight and Rulemaking; Implementation of Regulation Best Interest and Form CRS

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.

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

- ***The SEC suspended a CPA for engaging in "scalping."*** According to the complaint, the CPA engaged in scalping by secretly acquiring shares and/or interests in shares of two penny stock companies which he then promoted to investors through his penny stock platform publishing houses. The complaint alleges the CPA did not disclose his ownership of/interest in the share of the companies nor his plans to sell his interests following the promotion’s dissemination. Per the complaint, the CPA failed to properly disclose the consideration received for the promotions and failed to comply with beneficial ownership reporting requirements.

- ***The SEC instituted public administrative and cease-and-desist proceedings against an Audit Partner in connection with a cheating scandal on an internally administered training course.*** The complaint alleges that the accounting firm performed an internal investigation after learning its audit professionals cheated on its internal training exams. Per the complaint, the Partner solicited and received answers to the exams from a colleague. Despite instructions to the contrary, the Partner deleted text messages from his colleague including pictures of the questions and answers to the exam. The complaint further alleges the Partner falsely answered he had not received answers to the training exams which he subsequently self-corrected. As a result of these actions, the Partner was denied the privilege of appearing or practicing before the Commission as an accountant for three years.
- ***A CPA was suspended for engaging in insider trading.*** According to the complaint, while working as an accountant in the company's revenue recognition department, the CPA was told that the company's revenue for the second quarter of 2019 would be disappointing. The complaint alleges that on the basis of this material nonpublic information, the CPA bought a total of 50 short-term out of the money put option contracts. Following the company's lower than expected revenue guidance, its stock price dropped approximately 16%. Per the complaint, the CPA sold the 50 option contracts and netted nearly \$250k in profits. The CPA was denied the privilege of appearing or practicing before the Commission as an accountant and was ordered to pay disgorgement and a civil money penalty.

Financial Reporting Fraud

We categorized 8 AAERs as Financial Reporting Fraud during the quarter. The following are examples of releases within this category:

- ***The SEC instituted cease-and-desist proceedings against a CEO for certifying misleading SEC filings.*** Per the complaint, the CEO signed and certified materially misleading disclosures in periodic filings with the Commission regarding the nature and growth of the company's customer base and reliance on its largest customer. Specifically, the complaint alleges the company stated in its Form 10-K for 2013 and its quarterly filings for the first and second quarters of 2014, that its largest customer and a related party with affiliated customers, accounted for a small percentage of its customer base. The disclosures were materially misleading as 90%-97% of the company's customer base was referred in and capitalized by one customer.
- ***The SEC charged an underwriter of specialty insurance products with issuing deficient proxy statements.*** According to the complaint, the company failed to disclose \$5.3 million worth of perquisites and personal benefits provided to the CEO, who was also the President and director of the company. The complaint alleges items paid for by the company on behalf of the CEO included expenses associated with personal use of corporate aircraft, rent and other housing costs, personal use of corporate automobiles, helicopter trips, other personal travel costs, use of a car service by family members, club and concierge service memberships, and tickets and transportation to sporting, fashion or other entertainment events, among other items. As alleged in the complaint, the company incorrectly recorded these payments as business expenses and not compensation, therefore, they were ordered to pay a \$900,000 civil penalty.

"The statement also reminded corporate issuers to strive for consistency across their various public and confidential disclosures and to fulfill their legal requirements with respect to the disclosure and dissemination of material non-public information."

Chairman Jay Clayton and Rebecca Olsen, Director, Office of Municipal Securities
May 4, 2020
The Importance of Disclosure for our Municipal Markets

- ***The SEC charged a real estate investment trust with violating the antifraud and books and records provisions of the federal securities laws.*** According to the complaint, the real estate investment trust (“REIT”), acting through its then CFO and CAO, falsely reported and manipulated the company’s Funds from Operations and Adjusted Funds from Operations, key metrics for REITs. The complaint alleges that instead of correcting the reported amounts, the CFO and CAO chose to conceal the misstatement and make further intentional errors in order to meet analysts’ consensus expectations. The complaint alleges that despite employees’ objections, the CFO instructed the accounting team to use the manipulated numbers and calculations in their Form 10-Q and related earnings releases, filings that were later certified by the CFO and CAO. An \$8 million civil penalty was levied against the REIT because of this violation.

FCPA Violations

There were 2 FCPA-related releases in Q2 2020 resulting in more than \$137 million in civil money penalties, disgorgement, and prejudgment interest. Below is an example of a release within this category:

- ***The SEC instituted cease-and-desist proceedings against a global pharmaceutical and healthcare company for violating the books and records and internal accounting controls provisions of the FCPA.*** According to the SEC, between 2012 and 2016, the company’s subsidiaries and affiliates engaged in improper activities to increase the use of the company’s products in several markets. The complaint specifically alleges the company’s local subsidiaries and affiliates in Korea, Vietnam, and Greece engaged in schemes to make improper payments or to provide benefits to public and private healthcare providers in exchange for prescribing or using the company’s products. Per the complaint, the company lacked sufficient internal accounting controls with respect to the operations of these subsidiaries and affiliates and violated the books and records and internal accounting controls provisions of the FCPA. The SEC and U.S. Department of Justice ordered the company to pay more than \$346 million in criminal fines, disgorgement, and prejudgment interest for this violation.

Reinstatements

There were 4 releases in Q2 2020 related to the reinstatement of CPAs to practice before the SEC. The following is a summary of one release within this category:

- ***The Commission reinstated a CPA to appear and practice before the Commission as an accountant.*** According to the Commission’s initial complaint, the CPA, as the External Reporting Lead of an agricultural and seed chemical company, approved an improper accounting methodology. The complaint alleges the CPA should have known that certain rebates had been incorrectly recorded as Selling, General, and Administrative expenses. The complaint also alleges the company did not have sufficient internal accounting controls to identify and properly account for rebate payments promised to customers, which resulted in materially misstated reports filed with the Commission. The CPA complied with the term of the suspension and was therefore reinstated to appear and practice before the Commission as an accountant.

“The SEC’s commitment to investor protection and market integrity is unwavering, and we are laser-focused on identifying bad actors who would seek to use the current uncertainty to prey on our investors.”

Chairman Jay Clayton and William Hinman, Director, Division of Corporation Finance
April 8, 2020

The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19

Other

We categorized 4 releases in Q2 2020 as Other. The following is an example of a release within this category:

- ***The SEC imposed remedial sanctions and instituted a cease-and-desist order against a company for violating the Advisers Act.*** According to the complaint, the company, which was registered with the Commission as an investment adviser, failed to timely distribute audited financial statements prepared in accordance with GAAP to its investors, in violation of the “custody rule.” The complaint alleges the company also failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. A civil penalty of \$60,000 was levied against the company as a result of this violation.

Notable Q2 2020 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.

Accounting and Auditing Enforcement Release No. 4133 / April 28, 2020, In the Matter of Penn West Petroleum Ltd., d/b/a Obsidian Energy Ltd.

Even Well Designed Internal Controls are Meaningless When Management Lacks Integrity

The United States Securities and Exchange Commission recently announced in an Accounting and Auditing Enforcement Release that it reached a settlement with the former CFO and former vice president of accounting and reporting (“former officers”) of Penn West Petroleum, Ltd., (“company”) a Canadian public oil and gas entity, arising from an alleged accounting fraud at the company.

Without admitting or denying the allegations, the former officers agreed to be permanently enjoined from violating the record keeping, internal control and anti-fraud provisions of the securities laws, and to pay monetary penalties. The SEC previously reached a settlement with the company and another former employee.

The company was one of the largest oil producers in Canada and per the SEC, in 2012, 2013, and the first quarter of 2014, the former officers developed a scheme to understate publicly reported operating expenses, and thereby increase related financial metrics and ratios. In the oil and gas industry, operating cost ratios that measure how efficiently an entity is employing its capital in the production process are followed closely by industry analysts and investors.

Below we will provide an overview of the alleged scheme, describe the internal controls that were in place but not followed thereby allowing the alleged fraud to occur, discuss auditing guidance related to the alleged scheme and, importantly, considerations for audit committees of public registrants, working with their legal counsel, to avoid similar problems.

“Ensuring that investors and other market participants have access to high-quality, reliable disclosure, including financial reporting, is at the core of our efforts to promote each of those objectives.”

SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, and SEC Division of Investment Management Director Dalia Blass
April 21, 2020
Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited

Overview of the Alleged Scheme

The accounting practices involved in the scheme are relatively simple. The former officers allegedly directed the recording of journal entries to “reclassify” operating expenses into other parts of the company’s financial statements. In total, the entries resulted in hundreds of millions of dollars of operating expenses being moved to asset accounts on the balance sheet as well as into royalties for the use of land accounts. Of significance, the entries were recorded without adequate documentary support and per the SEC had no basis in reality.

In addition to the “reclass to capital” and the “reclass to royalty” entries (also boldly referred to at the company as “UOCR,” for uniform operating cost reduction entries), the former officers allegedly managed their reported earnings by releasing excess accrued expenses recorded in prior accounting periods. This practice was referred to internally as “accrual softening.”

Do note, reclass entries may be appropriate adjustments when expenses are initially recorded to an income statement account, but represent expenditures that benefit future periods and therefore should be accounted for as assets subject to amortization. Also, if an accrued expense is no longer necessary, then it should be released in its entirety into income, not used periodically as a way to lower operating expenses and increase income in a manipulative manner.

Internal Controls and Adjusting Journal Entries

Recognizing that entries to reclass expense items to asset accounts, and other adjustments that require judgment can be used to manipulate an entity’s financial results, businesses should require supporting documentation and analysis to be prepared and presented along with any proposed journal entry. In fact, the company had such a requirement documented in its internal controls over financial reporting. Per the SEC, the company’s policy stated,

“[a]ll journal entries must have supporting documentation that show the nature of the entry and provide adequate support to show how the amounts are calculated.”

The company’s journal entry procedures also required that the supporting documentation be scanned and uploaded to the company’s accounting system as an attachment to each journal entry and provided to an authorizer for review. Typical documentation that would meet this requirement may include memos describing the transaction, discussing the accounting treatment and providing citations for accounting guidance, spreadsheet analyses, and similar documents.

Needless to say, the entry should never be recorded nor approved without proper supporting documentation. However, per the SEC,

“The journal entries...were made without the required analysis and supporting documentation necessary to determine whether the operating expenses at issue were truly capital in nature. In numerous instances...these journal entries had no supporting documentation attached. Journal entries made by an accounting staff member were required to be approved by an authorized staff member. Despite the lack of support for the journal entries, they were approved without comment or inquiry...”

The combination of management lacking integrity and the ability to disregard well designed controls created a situation ripe for fraud. The situation also raises the question: should the audit team have identified the alleged fraud, especially noting the unsupported journal entries?

“If financial information is to be useful to investors, it must be relevant and faithfully represent what it purports to represent.”

Sagar Teotia, Chief Accountant
June 23, 2020
Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19

The complaint against the company states that auditors were misled by the former officers' materially false statements. However, audit guidance specifically requires auditors to consider tests of journal entries fitting the description of those made at the company.

Auditors and Tests of Journal Entries

The Public Company Accounting Oversight Board ("PCAOB") is the entity that promulgates guidance for auditors of public registrants in the United States. The guidance is commonly referred to as generally accepted auditing standards ("GAAS").

Included within the PCAOB's guidance in Auditing Standard 2401, *Consideration of Fraud in a Financial Statement Audit*, auditors are advised to specifically consider tests of journal entries when assessing the risk of management's override of internal controls. Per the guidance, auditors should consider *examining journal entries and other adjustments for evidence of possible material misstatement due to fraud*.

The guidance further states,

"Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (a) recording inappropriate or unauthorized journal entries throughout the year or at period end, or (b) making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidating adjustments, report combinations, and reclassifications. Accordingly, the auditor should design procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments (for example, entries posted directly to financial statement drafts) made in the preparation of the financial statements."

While more information is needed to know how the auditors were misled, it's useful to note that the alleged scheme aligns with the auditing standard above as a risk for auditors to consider when testing for financial reporting fraud.

Considerations to Avoid Similar Problems

With the above discussion as background, there are several useful lessons and considerations for the audit committees of public registrants, working with their legal counsel, to avoid similar problems, including,

- Importance of ethics training and the effective use of a whistleblower hotline or tool.
- Inquiry by the audit committee of the internal and external auditors regarding journal entry documentation and compliance with internal controls.
- Recognizing pressures related to the industry's key performance indicators and metrics, not just revenue and earnings targets.
- System blocks for non-compliance; if no support is uploaded, then the journal entry is incomplete and not recorded.

Remarkably, the company had well designed internal controls for recording journal entries. The controls were just not employed by management and overridden. Also, it appears many knew about the unsupported journal entries, yet no one raised a concern to the audit committee. Adding to these problems, the auditors never detected the unsupported journal entries, which based on the SEC's allegations were material and recorded at period end, creating what appear to be obvious indications of fraudulent activity. Considering all of these contributing factors that created an environment wherein the alleged fraud could occur, there is one overall theme and lesson from the case: there is no substitute or greater control than management integrity and an ethical corporate culture.

"This commitment to high-quality disclosure standards—including meaningful, principled oversight and enforcement—has long been a focus of the SEC and, since its inception, the PCAOB."

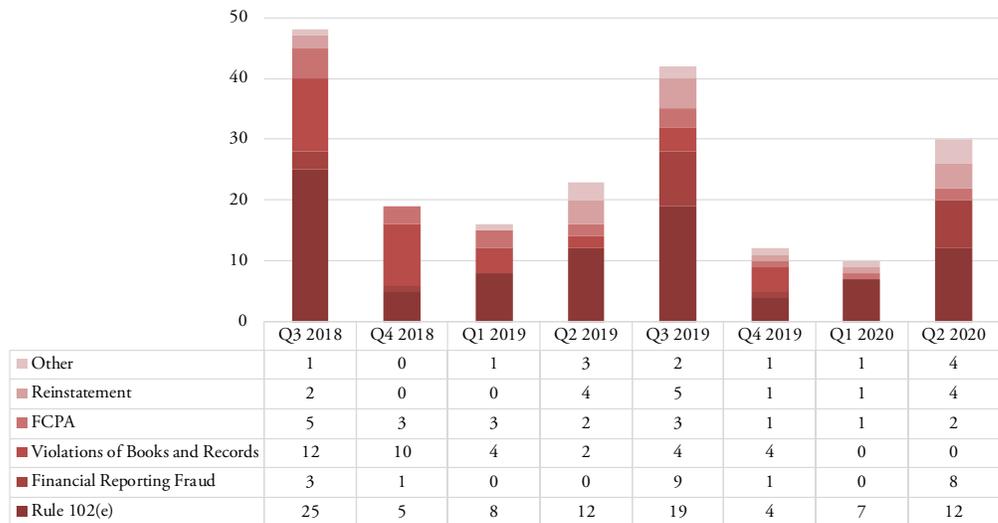
SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, and SEC Division of Investment Management Director Dalia Blass
April 21, 2020
Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited

Prior Period Comparison: Quarter to Quarter

As described in the section titled “Our Process and Methodology,” AAERs are intended to highlight certain actions and they do not represent an exhaustive and complete compilation of all actions that fit into the definitions provided by the SEC for the various AAER classifications. That said, comparisons of the number of AAERs between periods can be a useful gauge of the SEC’s activities.

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

Quarter to Quarter AAER Comparison
Q3 2018 through Q2 2020



“In the face of the uncertainties caused by COVID-19 and circumstances in which we all must prioritize health and safety, they have remained committed to our mission, focusing on the interests of our long-term Main Street investors and the integrity of our markets.”

Chairman Jay Clayton
April 8, 2020
Statement at Open Meeting on Securities Offering Reform for Business Development Companies and Closed-End Investment Companies

Based on this data, we made the following observations:

- Following the first quarter of 2020 in which the SEC released the lowest number of AAERs in over 12 years, in part, due to the COVID-19 pandemic, the SEC released thirty AAERs in Q2 2020, representing a 200% increase.
- Nevertheless, we observe a slight downward trend in the number of AAERs released per quarter in recent periods. For the twelve-month period ending Q2 2020, the SEC released an average of 23.5 AAERs per quarter as compared to an average of 26.5 AAERs per quarter for the twelve-month period ending Q2 2019.
- Interestingly, similar to last quarter, we did not observe any releases classified as Violations of Books and Records, which represents the first time since Q4 2017 in which the SEC did not release an AAER categorized as a Violation of Books and Records for two consecutive quarters.

Special Feature

Foreign Corrupt Practices Act: A Trend Analysis of FCPA Violations for the Five-Year Period Ending June 30, 2020

Given the recent market turmoil due to the COVID-19 pandemic combined with on-going renegotiations of trade agreements with the United States' largest trading partners, we analyzed recent actions related to the Foreign Corrupt Practices Act released by the SEC's Division of Enforcement for the five-year period ending June 30, 2020. The Division of Enforcement at the U.S. Securities and Exchange Commission 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 on FCPA violations provide multinational public registrants useful interpretations of the FCPA and highlight specific areas of focus.

The FCPA of 1977 was enacted to prohibit companies, and their individual officers, from influencing foreign officials with personal payments or rewards. The act applies to all U.S. businesses, foreign corporations that trade on U.S. stock exchanges, and any American national, citizen, or resident acting in the furtherance of a foreign corrupt practice, regardless of their physical presence. The SEC and the United States Department of Justice ("DOJ") are jointly responsible for enforcing the FCPA, with the SEC focusing on companies it regulates and the DOJ focusing on all other domestic companies. The actions governed by the FCPA include bribery of any kind, including cash or non-cash items, without any consideration of a materiality threshold. Thus, the main focus of the FCPA is on the intent of the bribe and whether the purpose was to influence a foreign official, rather than a nominal monetary value. Actions covered under the act include cash items, gifts, trips, internships, and employment for family members, among many others.

For individuals employed by multinational corporations, adherence to the FCPA is of particular importance. Our objective was to summarize and report on certain macroeconomic trends identified through our review of FCPA actions from the SEC's Division of Enforcement.

The SEC's Division of Enforcement has released information on 78 FCPA violations since the second quarter of 2015. Notably, these violations appear in various industries and in countries across the globe. As part of our review, we gathered information and key facts on each violation, identified common attributes, and noted certain trends. Importantly, when reviewing FCPA trends, one must consider not only the specifics of the violation, but also the geopolitical environment at the time of prosecution and its potential influence on the case.

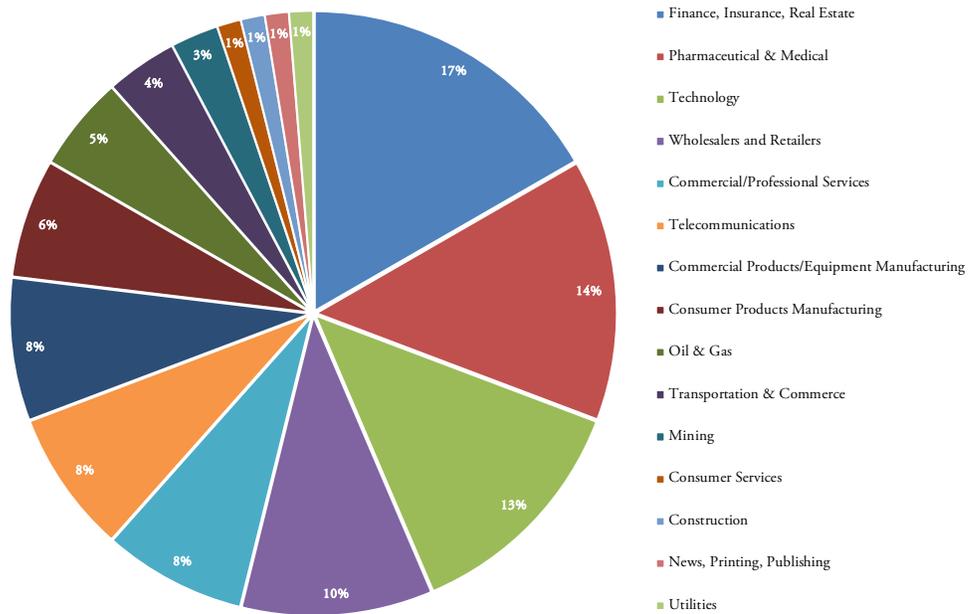
"The bedrock of our globally interconnected capital market system has long been high-quality, reliable audited financial statements. Without high-quality, reliable financial information, capital markets do not function well, increasing capital costs and risks of misconduct, including the potential for investors to be defrauded."

SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, and SEC Division of Investment Management Director Dalia Blass
April 21, 2020
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Industry Trends

We first analyzed FCPA violations based on the industries in which the violations occurred.

FCPA Violations By Industry



“Still, significant barriers to effective inspections and regulatory oversight continue to exist in many emerging markets, including China.”

Chairman Jay Clayton
 May 4, 2020
 Statement Announcing SEC Staff Roundtable on Emerging Markets

Notably, over the previous five years, three industries (Finance, Insurance, & Real Estate; Pharmaceutical & Medical; and Technology) account for nearly half of all FCPA violations (44%). Interestingly, violations within the Pharmaceutical & Medical industry were more prevalent in the beginning of our review period (i.e., 2015 & 2016) and more than half of the violations occurred in countries with existing socialized medical structures, most notably China and Russia. Many of the violations within these countries involved individuals providing improper benefits to doctors working in government-owned or managed hospitals in order to generate sales for their products. Given these doctors worked for state-owned facilities, their violations fell under the purview of the FCPA as the doctors are classified as foreign officials.

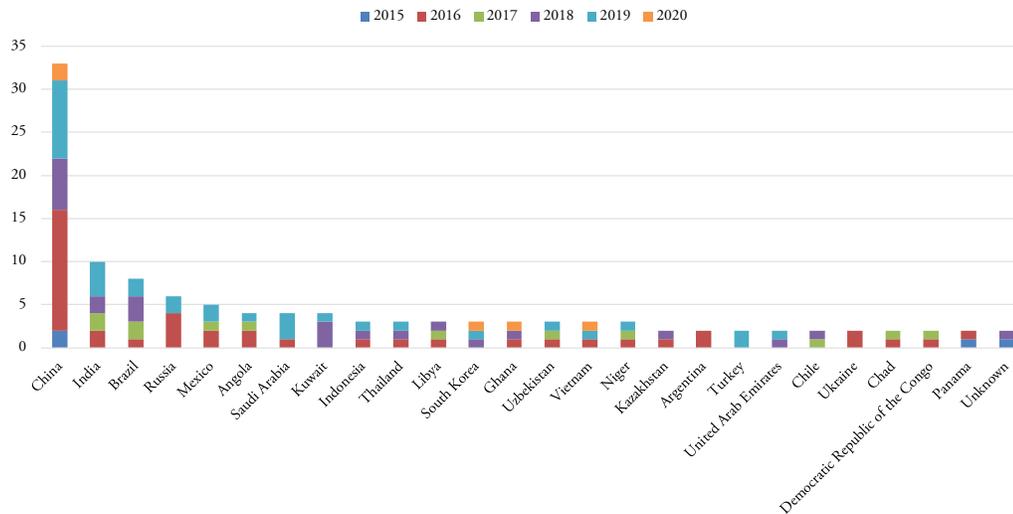
Further, there is a widespread practice called “Hongbao” in China that involves the payment of bribes to poorly paid doctors and hospital administrators. The bribes are paid by both the general public for preferred status in an over-strained medical system and by pharmaceutical manufacturers to further the use of certain prescription drugs. We expect to see a similar uptick in FCPA violations in the medical industry in 2020 and beyond, given the pressures of the COVID-19 pandemic and reliance on medical equipment and generic pharmaceuticals produced and sold overseas.

Conversely, although the SEC has focused on the Finance, Insurance, & Real Estate industry in recent years, there is no obvious trend, aside from the size of the industry, supporting the significant number of violations. Many of the FCPA violations within the Finance, Insurance, & Real Estate industry relate to bribes offered to powerful government officials in order to obtain or retain business and one of the most common violations included offering gifts and monetary benefits for the business of sovereign wealth funds. Furthermore, another interesting trend is that there has been a spate of violations for financial firms offering internships to family members of government officials. The internships were meant to generate lucrative financing deals for subsidiaries of multinational banks, and they highlight the importance of relationships in the cultures of certain emerging markets, particularly those in the Far East.

Geographical and Corruption Perceptions Index Trends

Next, we analyzed FCPA violations based on the countries in which the violations occurred. Please note, some violations (approx. 30%) involved misconduct in multiple countries; for example, one violation referenced misconduct in 17 countries. Therefore, the chart below reflects the total number of times each country was cited for misconduct within an FCPA violation (in other words, one FCPA violation can be counted multiple times). All countries with only one FCPA violation, of which there are 42, have been excluded from the chart below.

FCPA Violations By Country



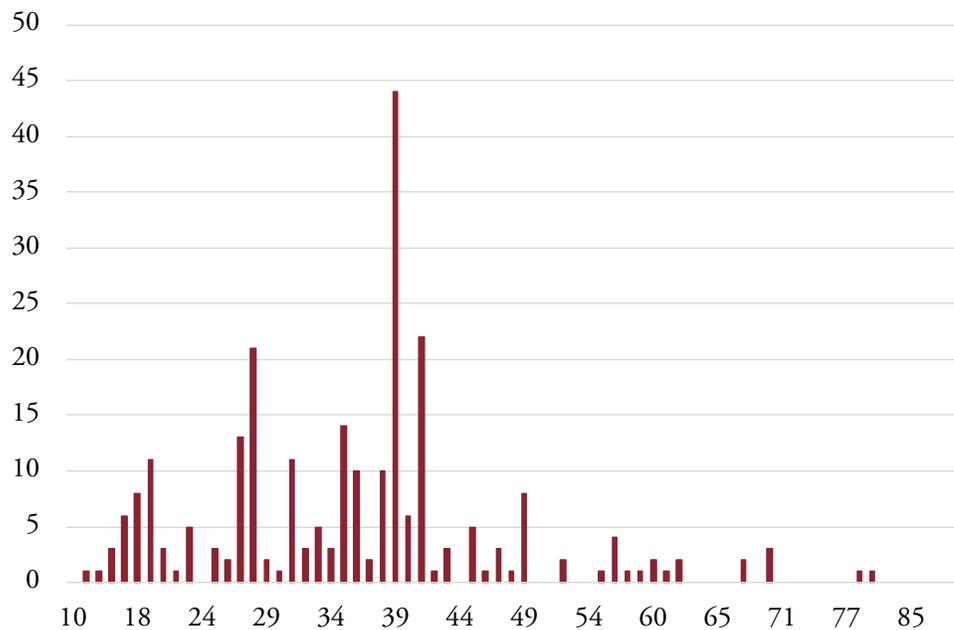
“In each of these meetings, the audit firms have recognized their responsibilities as auditors and acknowledged the importance of consistent audit methodologies across their global networks. We were clear in sharing our expectations that they fulfill these responsibilities.”

SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, and SEC Division of Investment Management Director Dalia Blass
 April 21, 2020
Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited

As evidenced in the chart above, China was referenced in over 42% of FCPA violations in the previous five years, almost twice the number of violations involving the second and third most prevalent countries, India and Brazil, combined. Furthermore, we also note that the majority of violations (approx. 65%) involving China relate to the Pharmaceutical & Medical; Wholesaler and Retailer; Finance, Insurance, & Real Estate; and Technology industries. Notably, these four industries account for 54% of violations in the rest of the world.

Given the prevalence of FCPA violations in China and their sustained perception of high public sector corruption, we performed a correlation analysis between the number of FCPA violations by country and each country's Corruption Perceptions Index ("CPI") in 2019 as published by Transparency International. The chart below presents the number of FCPA violations based on each country's 2019 CPI score.

Number of FCPA Violations by 2019 CPI Score



"Investments in emerging markets, including China, entail significant disclosure, financial reporting and other risks for U.S. investors."

Chairman Jay Clayton
 May 4, 2020
 Statement Announcing SEC Staff Roundtable on Emerging Markets

The Corruption Perceptions Index scores and ranks 180 countries and territories by their perceived levels of public sector corruption according to experts and businesspeople. The CPI is a composite index, combining 13 surveys and assessments of corruption collected by a variety of reputable institutions. As indicated in the chart above, the vast majority of FCPA violations occur in countries with CPI scores below 42 out of 100.

According to the CPI rankings, China has an average score of 39.6 out of 100 over the previous five years, placing them near the 50th percentile on the global scale of corruption. Although this may indicate that China should not account for a majority of FCPA violations, we note that China has historically been one of the top three trading partners of the U.S., so it appears logical that the SEC would focus on FCPA violations there. Also, as detailed above, there is a widespread culture of bribery in China, however, Chinese President Xi Jinping has made combatting corruption a major goal of his administration. In 2016, the Chinese government stated that over “one million” officials had been punished for corruption over the prior three year period.¹ Given the steps the Chinese government has taken to combat corruption, it will be interesting to monitor the trend in FCPA violations in China over the next few years.

Looking past China, we also analyzed FCPA violations in India, the country with the second most FCPA violations and noted several interesting trends when reviewing in conjunction with CPI rankings and U.S. trade rankings. First, India has an average CPI score of 40 out of 100 over the previous five years, placing them in the 55th percentile on the global scale of corruption. Second, India represents the United States’ ninth largest trading partner. When taken together, these rankings do not seem to support the significant number of FCPA violations in India, although they appear to highlight the lack of direct correlation between trade frequency and FCPA violations. Further highlighting this trend, the United States’ other top ten trading partners (excluding China and India) only account for 12% of FCPA violations over the previous five years, including five countries (Japan, Germany, United Kingdom, France, and Taiwan) that have no FCPA violations. This trend is most likely attributable to the increased self-policing of EU member nations. These countries have embraced the United States’ methods of prosecution of similar violations to great effect. For example, the United Kingdom recently passed its own version of the FCPA, the UK Bribery Act, which is in fact, stricter and more punitive than the FCPA.

“Our ability to promote and enforce these standards in emerging markets is limited and is significantly dependent on the actions of local authorities—which, in turn, are constrained by national policy considerations in those countries.”

SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, and SEC Division of Investment Management Director Dalia Blass
April 21, 2020
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¹ <https://www.bbc.com/news/world-asia-china-37748241>.

www.floydadvisory.com

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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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