

FLOYD ADVISORY LLC



Summary of Accounting and Auditing
Enforcement Releases for Three Months
Ended December 31, 2010

Floyd Advisory LLC is pleased to present you with our Summary of the U. S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAER's") for the three months ended December 31, 2010 ("Q4 2010").

As an independent boutique forensic accounting and business advisory 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 regarding civil litigation and administrative actions that are identified as "accounting and auditing" related are of special importance. Our objective is to summarize and report on the major items disclosed in the AAER's, while also providing useful insights that the readers of our report find valuable.

We welcome your comments and feedback, especially as to what additional analysis you would find helpful.

Floyd Advisory LLC
January 2011

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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 (“AAER”). Importantly, the disclosed AAER’s 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 AAER’s, while also providing useful

insights that the readers of our report find valuable, we reviewed the AAER’s identified and disclosed by the SEC on its website, www.sec.gov.

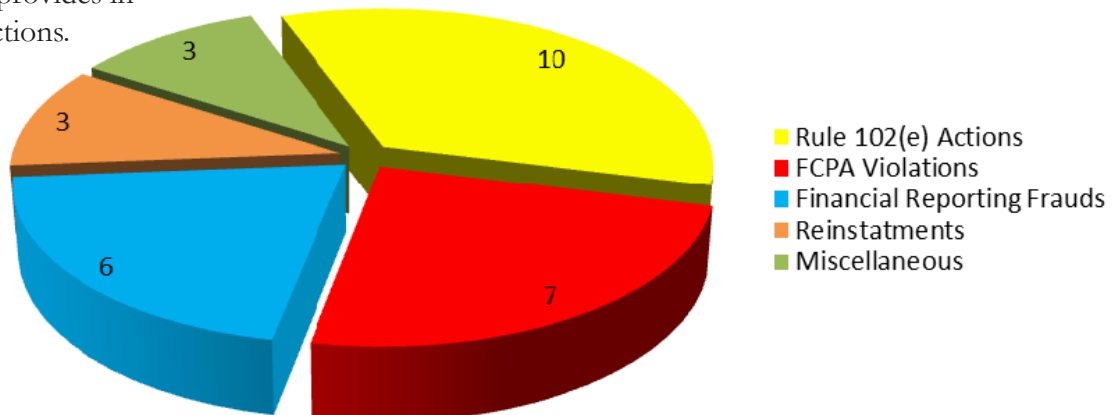
As part of our review, we gathered information and key facts, identified common attributes, noted trends, and observed material events. Applying our professional judgment, and based solely on the publicly disclosed information, we also sorted the releases into major categories (notably: Rule 102 (e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations (“FCPA”), Reinstatements to Appear and Practice before the SEC, and Miscellaneous) and classifications

for the financial reporting issues involved (notably: 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 for the key facts in each release.

The Q4 2010 AAER’s; Summary by Category and Insights from the Releases

The SEC disclosed 29 AAER’s during Q4 2010 which we have organized into the following categories as shown in the chart. While useful analytically to see the categorical breakdown for the releases, a closer look into each group provides insights on the SEC’s actions.

AAER's by Category



Rule 102 (e) Actions

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, which is 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.

Notably, of the ten individuals receiving Rule 102 (e) sanctions during Q4 2010, nine were certified public accountants and one was a chartered accountant. Two of the individuals were penalized for actions while serving as partners with public accounting firms and eight were penalized for roles at corporations related to either financial reporting or defalcation frauds.

The majority of the Rule 102 (e) AAER's actually relate to financial reporting frauds at two companies, Dell, Inc. and Delphi Corporation; with five individuals from Dell, Inc. and two individuals from Delphi Corporation being penalized for their conduct. When considering this fact, one may view the "ten" Rule 102 (e) AAER's as really relating to only five public registrant events.

FCPA Violations

With regard to financial penalties, the FCPA AAER category in Q4 2010 stands apart from the others with aggregate penalties, disgorgements, and interest for the seven releases exceeding \$196 million.

Interestingly, this tally does not include all FCPA actions by the SEC during Q4 2010 as the SEC settlement announced on December 27, 2010 with Alcatel-Lucent, S. A. for FCPA violations was not identified as an AAER.

The reported Alcatel-Lucent, S. A. penalties exceeded \$137 million, which when alone added to the seven FCPA AAER's would result in an adjusted tally of over \$333 million for FCPA actions in Q4 2010.

A closer look in the seven FCPA AAER's reveals a concentration of actions in the oil and gas industry, with five of the seven AAER's relating to oil and gas entities. Recognizing this fact, it's not surprising that Texas also held a dominant position, with six of the seven entities penalized in Q4 2010 conducting business in Texas.

As expected, each of the FCPA AAER's reported the frequently linked allegations of bribery and internal control violations when improper payments to government officials are discovered.

Financial Reporting Frauds

There were only six AAER's that we categorized as financial reporting frauds during the quarter; and included in that tally there are actually two releases for one registrant, making the number of registrant events merely five. The types of fraudulent behavior described in the releases include:

- A sales executive for Carter's, Inc., a clothing company, manipulated the amount of discounts granted to its largest wholesale customer, a national department store, in order to induce the customer to purchase greater quantities for resale. The salesman's fraud was concealed by his persuading the customer to defer taking the discounts and by misrepresenting the sales terms to his company's accounting department. The salesman was charged with engaging in financial fraud that resulted in a material overstatement of Carter's Inc's net income and with insider trading.
- Executives of a company, LocatePlus Holdings Corporation, created a false customer for the purpose of reporting revenue from transactions with the customer. The fabricated customer was funded with cash routed through entities controlled by the executives. The executives were charged with violations of the anti-fraud and the books and records provisions of the securities laws.
- A settlement was reached with the CEO of Converse Technology, Inc related to options backdating allegations. The CEO will pay \$47.6 million in disgorgement and prejudgment interest and a \$6 million penalty, which is one of the largest penalties imposed in an options backdating case.
- Vitesse Semiconductor Corporation and four of its former executive were charged with fraud related to revenue recognition and options backdating. Two of the executives and the company have settled, with the company paying a \$3 million penalty. The two other former executives, the CEO and the CFO, are contesting the allegations. The revenue recognition allegations involve channel stuffing, undisclosed side letters and oral agreements with customers including unconditional rights to return product and the failures to timely report credits related to customer's returned products.

- A Final Judgment was entered by the District Court for the Northern District of Illinois against the former CEO of Universal Food and Beverage Co., Duane Martin, permanently barring him from serving as an officer or director of a public company, among other court ordered items. Martin, who earlier in the year was sentenced to forty-one months in prison, charged with; improper stock offerings, improperly paying himself deferred salary amounts, misappropriations of company assets, misleading his outside auditors, and forging documents.

Reinstatements

During Q4 2010, three certified public accountants were reinstated to appear and practice before the SEC; two of which were granted the ability to serve as preparers and one granted the ability to serve as both a preparer and as an independent accountant. The positions held by the three at which time the issues giving rise to their sanctions arose include: CFO, partner at a regional accounting firm, and partner at a Big Four accounting firm.

Miscellaneous

The three releases included in the miscellaneous category represent an order regarding the SEC's review of a PCAOB decision which barred a CPA from associating with any registered public accounting firm and permanently revoking his firm's registration, and two AAER's related to Office Depot, Inc. which are discussed in detail below in our "recommended reading" section.

Speech by SEC Commissioner: An Insider's View of the SEC: Principles to Guide Reform

"The final principle I will discuss today that should guide the SEC is critical — the SEC must enforce the rules. As I have said many times, rules alone, without proper implementation and enforcement, are meaningless. How many countries around the world have rules on the books that are directly contradicted by the corrupt practices that take place - and where the regulators are nowhere to be found?"

by Commissioner Luis A. Aguilar
U.S. Securities and Exchange Commission

Berkeley Center for Law, Business and the Economy University of California at Berkeley Berkeley, California October 15, 2010

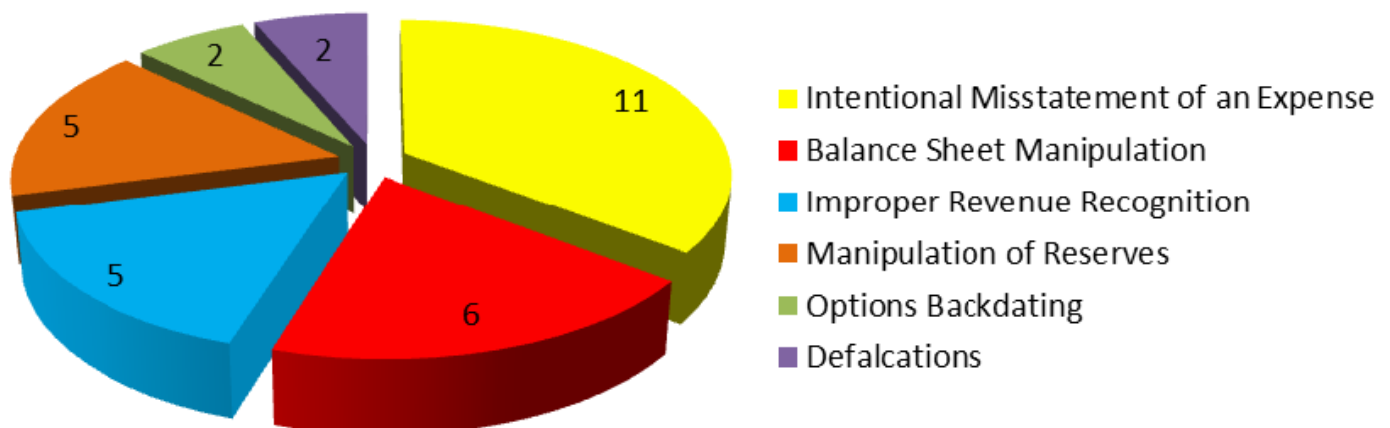
The Q4 2010 AAER's; Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in the Q4 2010 AAER's, 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 creating, maintaining, and releasing 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
Options Backdating	Intentional misdating of stock option awards
Defalcations	Thefts of funds and assets

The following chart provides the results of our financial reporting issue analysis for the Q4 2010 AAER's. Notably, the intentional misstatement of expenses problem was most prevalent due in part to the FCPA actions.

AAER's by Financial Reporting Issue



Notable AAER's for "Recommended Reading"

As with any group of filings, releases or decisions, some have more relevant content than others. While one may benefit from reviewing all the SEC's AAER's, there are certainly some that are worth further review and analysis by those involved with financial reporting matters. We deem these releases as earning the distinction of "recommended reading" for our clients.

For Q4 2010, we identified two "recommended reading" AAER's; the Office Depot release regarding proper applications and interpretations of Regulation FD and the Moore Stephens Wurth Frazer & Torbet LLP ("MSWFT") release regarding failures to conduct audits and reviews in accordance with PCAOB standards and rules.

Below we will provide an overview of the AAER's key facts, issues and our observations.

Securities and Exchange Commission v. Office Depot, Inc., Civil Action No. 9:10-cv-81239 (S.D. Fla. Oct. 21, 2010)

Per the AAER, Office Depot, Inc. ("Office Depot") violated Regulation FD in 2007 by selectively communicating with analysts that it would not meet analysts' quarterly earnings estimates.

Importantly, Regulation FD requires that when public registrants disclose material non-public information, they must make a broad public disclosure; anything less that creates a selective or limited disclosure is not acceptable.

Interestingly, based on reading the AAER, there does not appear to be any denial with regards to the Office Depot CEO, CFO, and director of investor relations' intent to communicate and steer the analysts to lower their estimates for Office Depot in June 2007, a time at which Office Depot management had knowledge that the company would likely miss expectations for Q2 2007 results.

However, in Office Depot's defense, they did not explicitly make any disclosure regarding their results when communicating with their analysts. Nevertheless, based on the SEC's review of the communications and talking points, enough was said in discussions with analysts and institutional investors to cross the "implied" line, thereby causing a violation.

The AAER provides a well written and detailed review of the actions and discussions by Office Depot executives, the rules and intent for Regulation FD, and the basis for the SEC's conclusion.

The inclusion of Office Depot's talking points for their communications with their analysts and institutional investors may be one of the most useful aspects of the AAER from an educational and training standpoint and are reported as follows (do note, the "Companies" referenced in the script, whose names have been omitted, are comparable businesses to Office Depot);

- Haven't spoken in a while, just want to touch base.
- At beg. Of Qtr we've talked about a number of headwinds that we were facing this quarter including a softening economy, especially at small end.
- I think earnings release we have seen from the likes of [Company A], [Company B], and [Company C] have been interesting.
 - On a sequential basis, [Company A] and [Company B] domestic comps were down substantially over prior quarters.
 - [Company C] mentioned economic conditions as a reason for their slow growth.
 - Some have pointed to better conditions in the second half of the year – however who knows?
 - Remind you that economic model contemplates stable economic conditions – that is mid-teens growth.

To the SEC, Office Depot's communications are prohibited as indirect "guidance" as defined in the Adopting Release to Regulation FD, 65 Fed. Reg. at 51,721 cited below as well as in the Office Depot AAER,

When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied.

As a final comment, a curious omission from the Office Depot AAER is whether legal counsel engaged in any discussion or was consulted with in regards to the planned communications. Certainly when dealing with sensitive disclosures and the application of securities laws, management for public registrants need to work closely with their legal counsel.

In the Matter of Moore Stephens Wurth Frazer & Torbet LLP and K. Dean Yamagata, CPA, Administrative Proceed- ing File No. 3-14167

MSWFT, a public accounting firm registered with the PCAOB and located in California, issued unqualified audit opinions on the financial statements of China Energy Savings Technology, Inc. (“China Energy”) for its 2004 and 2005 fiscal years, and issued interim review reports related to China Energy’s quarterly reports in fiscal year 2005.

Subsequent to the issuance of MSWFT’s audit opinions, material irregularities were identified in China Energy’s financial statements including the overstatement of revenues and earnings.

The AAER describes in a fair amount of detail the risks and red flags that were visible to MSWFT and MSWFT’s audit failures in responding to them with appropriate professional skepticism.

Examples of the risks visible to MSWFT were a lack of properly functioning internal controls, observing information which contradicted disclosures in China Energy’s annual reports, and a lack of competent accounting personnel on staff at China Energy. In addition, MSWFT encountered significant difficulties in conducting its audit procedures including being unable to fully perform an inventory observation and being unable to confirm bank and customer accounts as planned. However, the most significant audit failure appears to be MSWFT’s acceptance of representations from China Energy management regarding sales contracts to support revenue recognition treatment in lieu of inspecting the contracts themselves.

The AAER also details the independence rules and document retention rules violated by MSWFT which resulted from MSWFT performing accounting functions for China Energy and for not keeping correspondence from China Energy relating to revenue recognition issues.

Among the penalties incurred by MSWFT and Mr. Yamagata, the partner responsible for the China Energy audit, MSWFT shall retain an Independent Consultant who will be tasked with performing an assessment of MSWFT’s training and quality control programs for compliance with SEC regulations and PCAOB standards and rules. The Independent Consultant will provide a copy of their report directly to the SEC and the PCAOB.

While auditing involves many standards and rules, there are also many aspects that are heavily based on professional judgment. For this reason, the MSWFT AAER is a useful case study to assess and appreciate acceptable and unacceptable auditor judgments when confronted with high risk situations and unusual circumstances. Among the “lessons learned” from this situation are the risks inherent in accepting less than you ask for from your clients, that accepting rationalizations instead of clear answers and documentation is problematic, and when management integrity is lacking, the client is not worth the potential harm to one’s reputational capital.

Speech by SEC Chairman: “The Important Role You Play”

by
Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission
AICPA Annual Conference Washington, D.C.
December 6, 2010

“I urge all of you to ask yourself critical questions when you sit down with the numbers.

Questions like:

“Could I be doing more to ensure that the information is accurate?”

“Are the results I am reporting an exercise in wishful thinking or a true portrait of actual results?”

“Do I understand the company I am auditing well enough to recognize red flags and have I taken all appropriate steps to respond to them?”

“Even if the numbers reported are accurate, do they convey a fair picture, or is there a need for additional disclosure?”

And, if these questions do not yield the answers you need, I urge you to have the courage to challenge those answers — a willingness to take your judgments about the quality of disclosures to the highest levels of management and to the audit committee.”

Prior Period Comparisons; Year over Year and Quarter over Quarter Statistics

As described in our Process and Methodology section, AAER's 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 AAER's between periods can be a useful gauge of the SEC's activities.

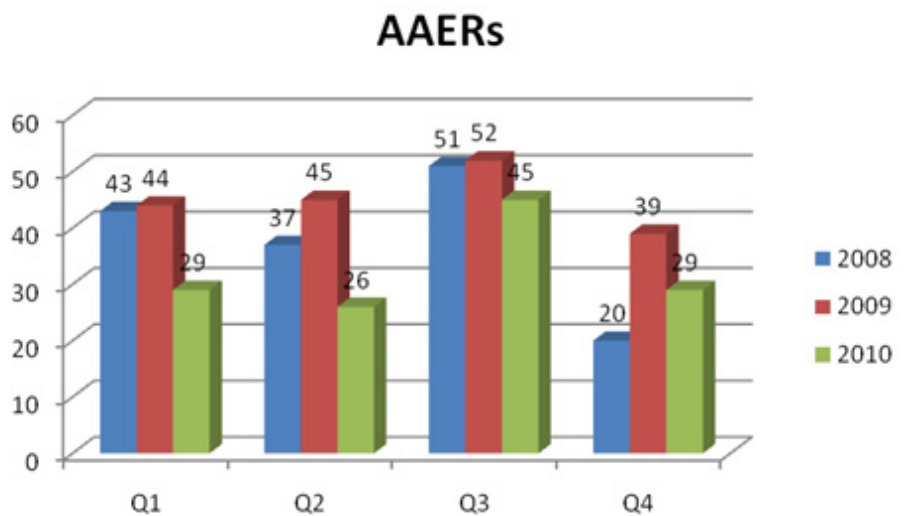
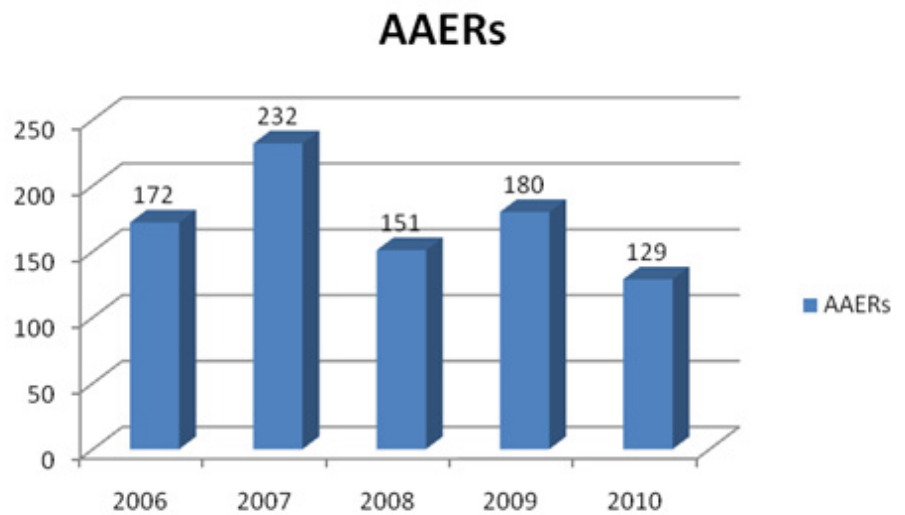
During 2010, the SEC issued 129 AAER's, remarkably the lowest number of AAER's for the prior five year period. For comparison, the SEC issued 180 AAER's in 2009 and the average of the prior four years from 2006 through 2009 was 183; both numbers indicating an approximate thirty percent reduction in AAER's for 2010.

When analyzing the AAER population on a quarterly basis for the years 2008 through 2010, the most obvious observation is the consistent rise sequentially between the quarters in 2009 from 2008, and the consistent decrease in the quarters from 2009 to 2010.

As mentioned above, the designation of actions as AAER's is not intended to be a complete and exhaustive compilation. However, the drop in activity in 2010 does create the possible perception that enforcement actions involving accounting and auditing issues are less preva-

lent, which leads one to speculate whether violations are less frequent or there may be more leniency in the SEC enforcement approach. Needless to say, the data is insufficient to allow one to conclude from simply a review of the AAER's.

As a final point, the largest volume of AAER's consistently occurs in the third quarter for each of the three years 2008 through 2010 presented above. Notably, September 30th, which marks the end of the third quarter, is a significant annual reporting date for the SEC.



Acknowledgement

We wish to acknowledge the valuable contribution to this analysis by Janet M. Floyd, CFE and Mason C. Hickman.

Contact Information

Joseph J. Floyd, CPA, JD, CFE, ABV
jfloyd@floydadvisory.com
212.867.5848

About Floyd Advisory LLC

Floyd Advisory LLC is an independent boutique forensic accounting and business advisory firm headquartered in 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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