Floyd Advisory

BUSINESS ADVISORY | FORENSIC ACCOUNTING

Summary of Accounting and Auditing Enforcement Releases for the Year Ended December 31, 2011

ANNUAL REPORT 2011

CONTENTS

Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the year ended December 31, 2011.

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

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

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

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

Floyd Advisory LLC
JANUARY 2012

Our Process and Methodology

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

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

As part of our review, we gathered information and key facts, identified common attributes, noted trends, and observed material events. Applying our professional judgment, which is based solely on publicly disclosed information, we 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 Other) and classifications of 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 of the key facts in each release.

REVIEW PROCESS

- **Gathered information and key facts**
- **Identified common attributes**
- **Noted trends**
- **Observed material events**
- **Sorted the releases into major categories**
- **Prepared a database of the key facts**

AAERs for Year Ended December 31, 2011: Major Observations and Insights

AAERs reported for Year Ended December 31, 2011:

127

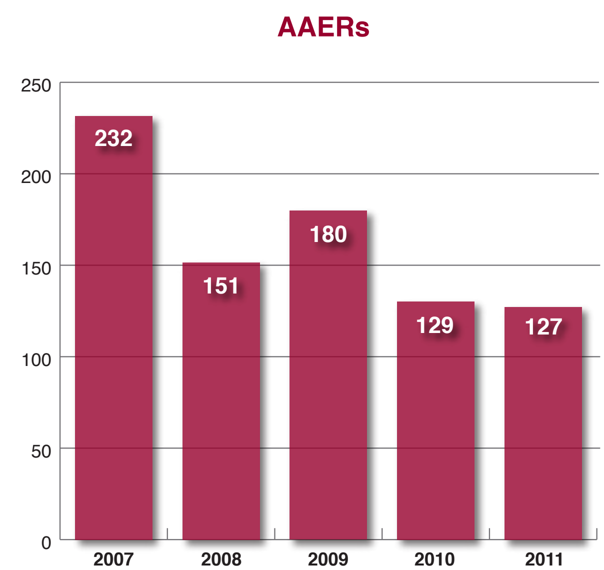
Average AAERs reported for 2007 – 2011:

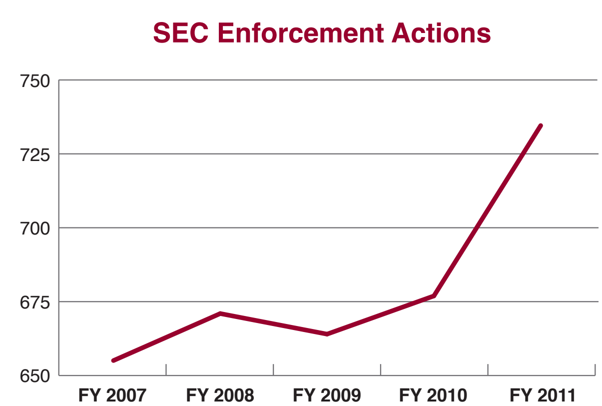
164

Lowest Number of Releases in Five Years; Yet Record Enforcement Year

For the year ended December 31, 2011, the SEC issued 127 AAERs, remarkably the lowest number of AAERs reported over the last five years. For comparison, the average for the periods 2007 through 2011 was approximately 164 releases, with the greatest number of releases issued in 2007.

In contrast to the recent lower number of AAERs, the SEC announced a record year for overall enforcement activity for the year ended September 30, 2011 inclusive of Federal Court Actions, Administrative Proceedings and AAERs.





To evaluate the contrast between the record volume of total enforcement actions to the decline in AAERs, one should consider the types of matters being handled by the SEC. Importantly, AAERs are intended to highlight certain enforcement 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 this classification. Furthermore, in our experience, matters reported as AAERs quite often arise out of financial reporting frauds and other related enforcement actions.

With these considerations in mind, the following table provides an insightful categorization of enforcement actions, with the majority of AAERs reported in the FCPA and Financial Fraud/Issuer Disclosure line items.

SEC Categorization of Enforcement Actions

For the Years Ended September 30,

Enforcement Actions by Fiscal Year	2007	2008	2009	2010	2011
Broker-Dealer	89	67	109	70	112
Delinquent Filings	52	113	92	106	121
FCPA	n/a	n/a	n/a	n/a	* 20
Financial Fraud/Issuer Disclosure	219	154	143	126	** 89
Insider Trading	47	61	37	53	57
Investment Adviser/Investment Co.	79	87	76	112	146
Market Manipulation	36	53	39	34	35
Securities Offering	68	115	141	144	124
Other	65	21	27	32	31
Total Enforcement Actions	**655**	**671**	**664**	**677**	**735**

*Prior to FY 2011, FCPA was not a distinct category and FCPA actions were classified as Issuer Reporting and Disclosure.
**Prior to FY2011, this category was reported as Issuer Reporting and Disclosure and included FCPA actions. In FY 2011, FCPA actions are tracked separately from financial fraud/issuer disclosure actions.

Notable among the results reported above are the increases in Broker-Dealer, Delinquent Filings, Investment Adviser/Investment Co. and Securities Offering enforcement actions.

Conversely, the financial fraud related matters (categorically shown above as Financial Fraud/Issue Disclosure matters combined with FCPA cases) decreased by approximately 50% from 2007 to 2011. Of significance, the financial fraud related matters represented approximately 33% of all SEC enforcement actions in 2007 compared to only approximately 15% in 2011. The chart on page 4 illustrates the decline in financial fraud related matters.

Sources: http://www.sec.gov/about/secstats2011.pdf
http://www.sec.gov/news/newsroom/images/enfstats.pdf

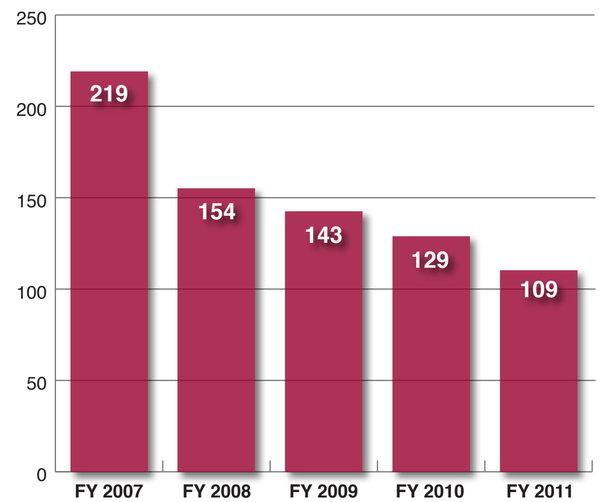
SPEECH BY SEC CHAIRMAN: REMARKS AT STANFORD CENTER ON LONGEVITY — FINRA INVESTOR EDUCATION FOUNDATION CONFERENCE

Today, there's a new energy and a smarter approach to the SEC's efforts: more experience and better training in the staff, more effective organization and improved collaboration; and upgraded IT to support it all. Perhaps most important of all, though, is our understanding that in an age of limited resources, the SEC has to work collaboratively with other organizations, agencies, academics, and activists to protect investors.

Chairman Mary L. Schapiro
U.S. Securities and Exchange Commission
Washington, D.C.
November 3, 2011

Over 40% of the AAERs reported in 2011 involved Rule 102(e) sanctions and violations, most often a "by-product" of a related financial fraud or offense.

Financial Fraud Related Enforcement Actions
For The Years Ended September 30,



*Inclusive of Financial Fraud/Issue Disclosure/FCPA matters

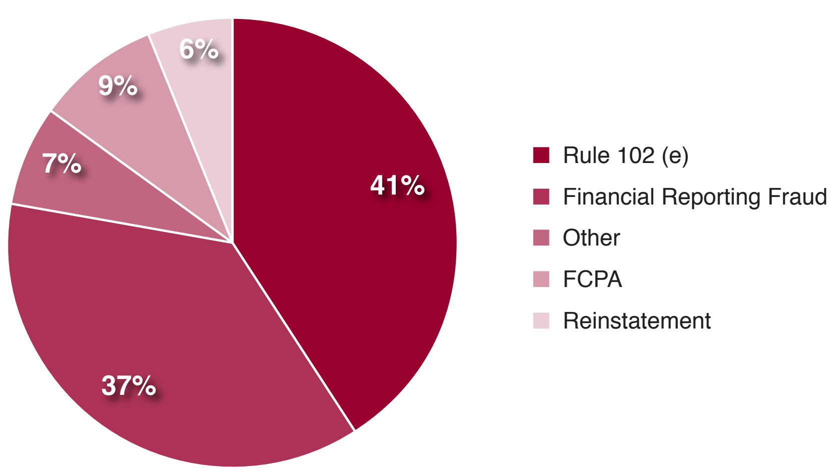
Based on a review of the reported data, one may surmise that the lower volume of AAERs is attributable to the drop in financial fraud related enforcement actions. The difficult premise to accept, however, is that financial fraud has so significantly declined over the last five years.

Individual and Firm Sanctions Earn the Top Position

To evaluate the types of AAERs issued in 2011, we sorted the releases into major categories: Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements, and Other.

Of note over 40% of the AAERs reported in 2011 involved Rule 102(e) sanctions and violations, most often a "by-product" of a related financial fraud or offense.

AAERs by Category



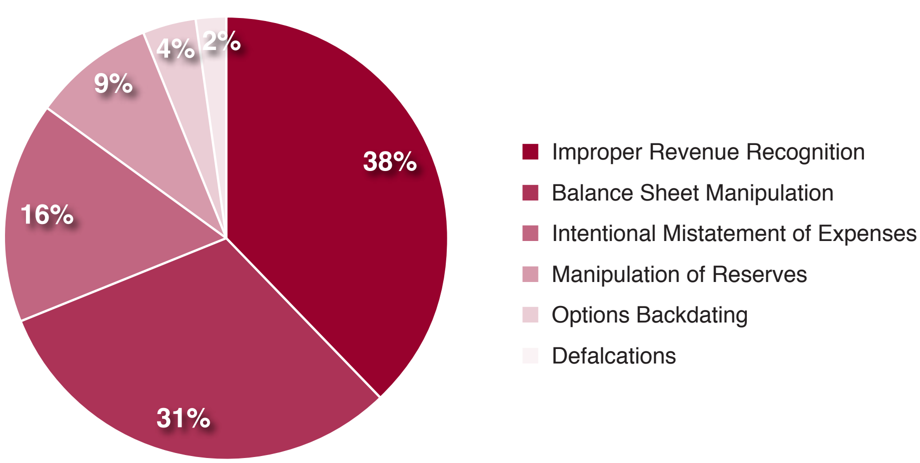
Rule 102(e) actions involve the censure and denial, temporarily or permanently, of the privilege of appearing or practicing before the SEC. For accountants, the standards under which one may be penalized with a Rule 102(e) action include; reckless as well as negligent conduct, which is defined as a single instance of highly unreasonable conduct that violates professional standards; repeated instances of unreasonable conduct resulting in a violation of professional standards and indicating a lack of competence.

Revenue Dominates Financial Reporting Problems

To report on the frequency of financial reporting issues involved in 2011 AAERs, we identified the accounting problem(s) in each AAER based on the classification definitions below:

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

AAERs by Financial Reporting Issue



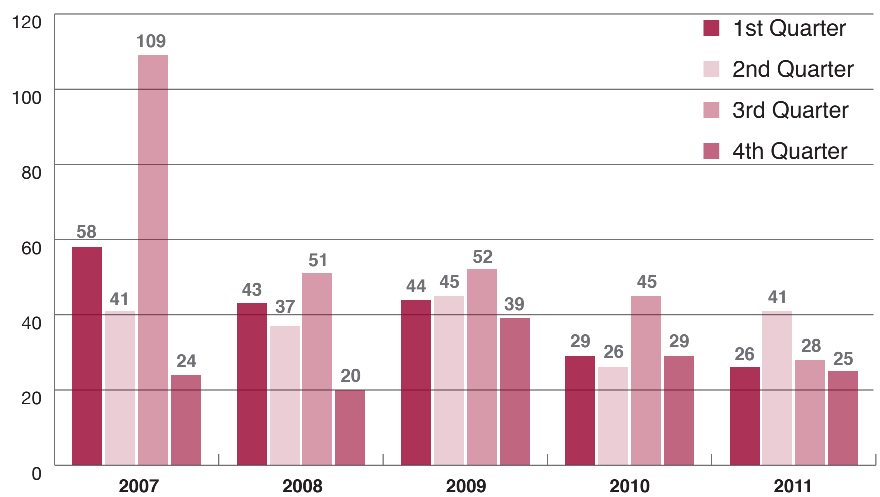
For accountants, the standards under which one may be penalized with a Rule 102(e) action include:

- **Reckless as well as negligent conduct**
- **Repeated instances of unreasonable conduct resulting in a violation of professional standards and indicating a lack of competence**

Quarterly Volume Reflects Similar Downward Trend

For the first time in five years, the releases issued in Q3 2011 were not the highest reported quarter in the year.

Quarterly Volume
For The Years Ended December 31,

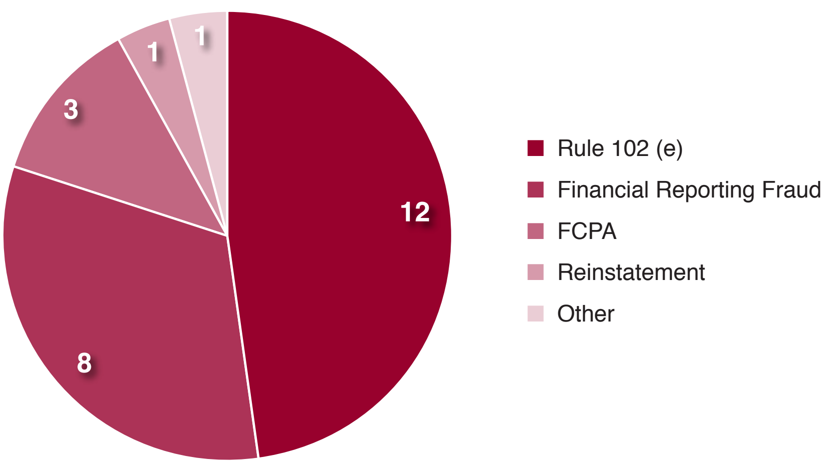


Consistent with the results for the five years ended December 31, 2011, the quarterly number of AAERs also reflects a downward trend. Notably, for the first time in five years, the releases issued in Q3 2011 were not the highest reported quarter in the year. Interestingly, the SEC's reporting period ends on September 30th.

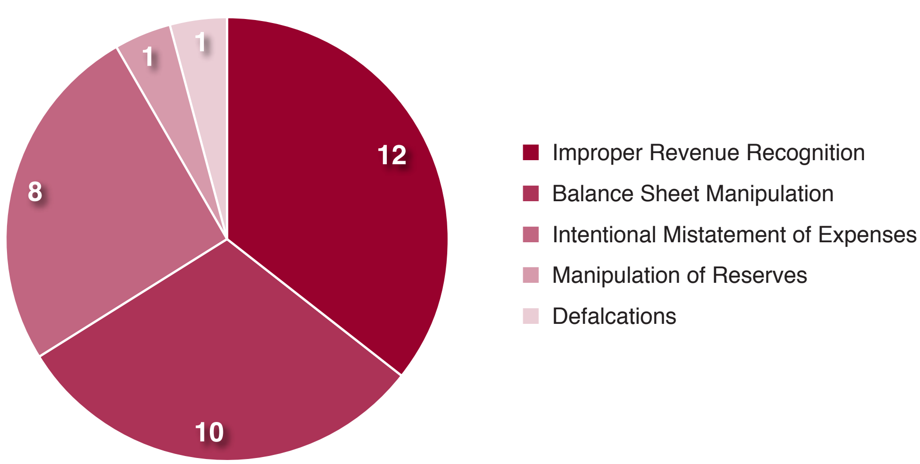
Overview of Q4 2011 AAERs

As part of our annual report on AAER activity, we provide an abbreviated version of our quarterly reporting for the final quarter of the year. The SEC reported twenty-five AAERs reflecting consistently with results of annual information presented earlier; Rule 102(e) action and revenue recognition are the leading category and financial reporting issue respectively.

AAERs by Category



AAERs by Financial Reporting Issue



The SEC reported twenty-five AAERs reflecting consistently with results of annual information presented earlier:

- **Rule 102(e) action and revenue recognition are the leading category**
- **Financial reporting issues follow**

AUDITING IN THE DECADE AHEAD: CHALLENGE AND CHANGE

DATE:

Dec. 1, 2011

SPEAKER(S):

James R. Doty, Chairman

EVENT:

Audit Quality Symposium, Canadian Public Accountability Board

LOCATION:

Toronto, Ontario

Internal control audits are not the leading indicators of the risk of misstatements in financial reporting that they are meant to be. Too often, auditors rely on imprecise business processes that are inapt as financial reporting controls. Or, they have failed to understand the flow of transactions in order to identify the points within a client's processes where a material misstatement could arise.

Q4 2011 "Recommended Reading" AAER

While reviewing all of the SEC's AAERs may prove insightful, certain releases present information that are worth 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.

Among the Q4 2011 AAERs, the release regarding the fraudulent revenue recognition scheme at Hansen Medical, Inc. ("Hansen") warrants special attention for the "lessons learned" with regard to how sales and operations personnel were able to subvert what appeared to be a properly structured and functioning set of internal control controls.

Securities and Exchange Commission v. Christopher Sells and Timothy Murawski, Civil Case No. CV-11-4941-HRL (N.D. Cal., filed October 6, 2011)

Hansen is a medical equipment company founded in 2002 and has been a public registrant since 2006. Unfortunately, Hansen is yet another example of the problems that rogue employees can cause a company.

In April 2008, Hansen hired a new Senior Vice President of Commercial Operations who then hired a new Director of National Accounts just a couple months later. The two had previously worked together for a different medical equipment company. Almost immediately in Q3 2008, the two individuals engaged in fraudulent activities regarding revenue recognition. Importantly, this was a time period when Hansen was involved in a securities offering, a fact known and apparently motivating for the two new employees.

An important factor to appreciate regarding revenue recognition in the healthcare equipment industry generally is the longer sales cycle which can create pressure on the timing for the recognition of revenue, and stress on salesmen to "close" transactions.

In addition to expected contractual agreements, to recognize revenue on Hansen's primary product, a robotic catheter system used in cardiac surgical procedures required both the installation of the equipment at a hospital as well as training for the hospital staff to be performed.

To evidence that the installation occurred, Hansen's field services personnel who would set the equipment up, would submit to the finance group an installation completion form, signed by the field services installer and a hospital representative. Because the system would not be operational unless personnel at the hospital were trained on how to use it, no revenue could be recognized until such training occurred.

To provide evidence that training occurred, Hansen's clinical group, the unit responsible to perform the training, would complete an acknowledgement form at the conclusion of the training signed by both the trainer and the trained hospital personnel. This form would also be submitted to finance, and both the training acknowledge form and the installation completion form would be reviewed by Hansen's customer service manager to ensure the forms were properly completed. Controls such as these would ensure that delivery had occurred to the customer and that the machine was functional.

With full knowledge of the revenue recognition policies and procedures, the defendants displayed a lack of integrity that the controls didn't anticipate; they had the equipment installed at the hospital and then dismantled and uninstalled it, then placed it in storage until the date that the hospital agreed to buy the system. To the hospital the process would appear as an on-site demonstration and in fact, due to the nature of conducting an on-site "demo", the requisite forms and signatures could be received and submitted to finance and customer service.

In addition, the defendants did other less laborious tasks to circumvent Hansen's controls including forged signatures, "side" agreements and outright misrepresentations to the finance group and the external auditors.

As with any financial reporting irregularity and especially those by rogue and unethical employees, the question arises whether Hansen could have done anything different to avoid and or detect the bad acts before consummated. While the entirety of the controls are not described in the release, it does appear that direct communication with the customer by the finance group, through a confirmation process or otherwise, would have signaled a problem. In addition, noting the long sales cycle for the industry, it would appear likely that a careful review of the customer file and purchase order dates may indicate the acceleration of the revenue recognition by the defendants. Possibly most useful for the people responsible for financial reporting is simply appreciating the outlandish ways and means that individuals may take to subvert properly structured and apparently well documented controls.

What could have been done differently:

- **Direct communication with the customer by the finance group, through a confirmation process.**
- **A careful review of the customer file and purchase order dates.**
- **Appreciating the outlandish ways and means that individuals may take to subvert properly structured and apparently well documented controls.**

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ACKNOWLEDGEMENT
We wish to acknowledge the valuable contribution to this analysis by Janet M. Floyd, CFE, Liz Klyuchnikova, and Meghan Arsenault.

ABOUT FloydAdvisory

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

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