Floyd Advisory

Summary of Accounting and Auditing Enforcement Releases for the Year Ended December 31, 2019

ANNUAL REPORT 2019

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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 ("SEC", "Commission"), Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the year ended December 31, 2019.

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 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
FEBRUARY 2020

Highlights:

- **SEC enforcement actions increased from 821 in Fiscal Year ("FY") 2018 to 862 in FY 2019, but we note that standalone enforcement actions actually decreased by 12% between FY 2018 and FY 2019 when excluding voluntary self-reported actions arising from the SEC's Share Class Selection Disclosure Initiative. For transparency and comparative purposes, the SEC should issue a "pro forma" enforcement score for FY 2019 that excludes voluntary self-reported cases, similar to the SEC's reporting in FY 2017.**

- **The Dodd-Frank Whistleblower Program has granted 67 awards since its inception over eight years ago, which represents 0.2% of the over 33,000 allegations the office has received since the program's implementation. Given the low number of awards as compared to the number of allegations, it may be time for the SEC to consider a cost-benefit analysis to assess whether the benefits from the tips and allegations received warrant the invested effort and costs.**

- **Rule 102(e) Actions accounted for 46% of total AAERs in FY 2019, a trend that has persisted over the last five years where Rule 102(e) Actions, on average, have accounted for over 50% of total AAERs. The 43 releases categorized as Rule 102(e) Actions in FY 2019 accounted for $66 million of penalties imposed, a significant increase in penalties of over $48 million when compared to FY 2018.**

- **In our "Recommended Reading" section, we use the case involving Calumet Specialty Products Partners, L.P. as an example of how internal and external pressures can force a company to issue financial results prematurely in contravention of corporate governance systems and disclosure controls. We discuss the traditional roles and responsibilities of those with financial reporting oversight, how those roles may shift under various circumstances, and offer suggestions for legal counsel to consider in order to avoid the types of problems Calumet encountered.**

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 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 Fraud, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC ("Reinstatements"), 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.

Highlights from the SEC Annual Report for the Twelve Months Ended September 30, 2019

The SEC Should Restore "Pro Forma" Reporting of Enforcement Actions to Provide Greater Transparency into Self-Reported Matters

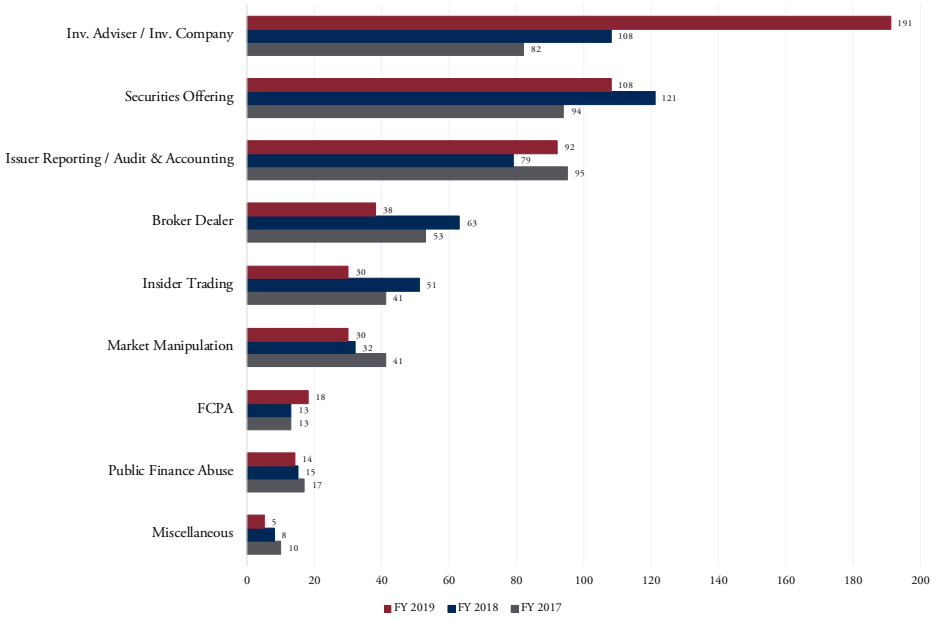
When the new leadership at the SEC took over in 2017, they added a level of transparency when issuing results that set a new standard for what types of cases deserve recognition. In particular, the SEC began to publish results that excluded matters arising out of the Municipalities Continuing Disclosure Cooperation Initiative, a voluntary self-reporting program related to flaws in required disclosures for municipal bond offerings. In February 2018, the SEC implemented a similar voluntary self-reporting program, the Share Class Selection Disclosure Initiative ("SCSDI"), and disclosed 95 investment advisory firms that self-reported failures to disclose conflicts of interest, which qualified as enforcement actions in FY 2019. Given the similarities between these two initiatives, we believe the SEC should reintroduce "pro forma" reporting that removes the voluntary self-reported cases like they did in 2017 to avoid disclosing inconsistent results.

"We designed the Share Class Initiative to give firms the opportunity to address the problem as promptly as possible and to achieve our goals of identifying firms engaged in these violations and returning money to harmed investors. The Initiative achieved both goals. As of today, 95 investment advisory firms have collectively agreed to return over $135 million to affected mutual fund investors and to make full and fair disclosure of their share class selection practices."

Stephanie Avakian, Co-Director, Division of Enforcement, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference, London, England, Nov. 5, 2019

When reviewing the types of matters handled by the Division of Enforcement in FY 2019, it is clear the SCSDI played a major role in the overall increase of enforcement actions: actions involving investment advisers and investment companies increased 77% from FY 2018 and accounted for 36% of the total standalone enforcement actions for the year. Notably, this significant increase represents the largest year-over-year increase for any enforcement category over the previous three years. Interestingly, despite the 7% increase in standalone enforcement actions in FY 2019 as compared to FY 2018, multiple enforcement categories decreased from FY 2018, including insider trading, broker dealer, miscellaneous, securities offering, public finance abuse, and market manipulation, some of which experienced decreases of greater than 35%.[1] We observed increases of approximately 38% for matters involving FCPA and 16% for issuer reporting/audit & accounting cases between FY 2018 and FY 2019.

Standalone Enforcement Actions by Classification
FY 2017 to FY 2019



1 The "Miscellaneous" category refers to the summation of the following categories: SRO or Exchange, NSRO, Transfer Agent, and Miscellaneous.

Standalone Enforcement Actions								
Classification	FY 2019		FY 2018		FY 2017		FY 2016	
	#	%	#	%	#	%	#	%
Inv. Adviser / Inv. Company	191	36%	108	22%	82	19%	98	21%
Securities Offering	108	21%	121	25%	94	21%	90	19%
Issuer Reporting / Audit & Accounting	92	17%	79	16%	95	21%	93	20%
Broker Dealer	38	7%	63	13%	53	12%	61	13%
Insider Trading	30	6%	51	10%	41	9%	45	10%
Market Manipulation	30	6%	32	6%	41	9%	30	6%
FCPA	18	3%	13	3%	13	3%	21	5%
Public Finance Abuse	14	3%	15	3%	17	4%	13	3%
Miscellaneous	5	1%	8	2%	10	2%	13	3%
Totals	**526**	**100%**	**490**	**100%**	**446**	**100%**	**464**	**100%**

Given the impact of the SCSDI on FY 2019 results, we believe the SEC should reintroduce "pro forma" reporting that excludes the voluntary self-reported cases. The SEC did not include any voluntary self-reported cases brought in FY 2018 through the SCSDI in their FY 2018 enforcement results as the program deadline ended June 12, 2018 and they had not yet finalized settlements with any firms. Therefore, as shown in the chart below, after removing the number of voluntary self-reported enforcement actions involving investment advisers or investment companies from FY 2019 results, a distinctive trend emerges: standalone enforcement actions decreased by 12% between FY 2019 and FY 2018 and decreased by over 7% when comparing FY 2019 to FY 2016.[2] Furthermore, after removing voluntary self-reported actions, standalone enforcement actions are at their lowest level in the last four years. This highlights an important trend: standalone enforcement actions brought by the SEC are on the decline while self-reported enforcement actions are on the rise, a trend obscured by the SEC's current reporting structure. Curiously, this trend may also indicate a potential shift in the Commission's long-term enforcement strategy to one that encourages self-reporting.

Standalone Enforcement Actions (Pro Forma)								
Classification	FY 2019		FY 2018		FY 2017		FY 2016	
	#	%	#	%	#	%	#	%
Inv. Adviser / Inv. Company	96	23%	108	22%	82	19%	98	21%
Securities Offering	108	25%	121	25%	94	21%	90	19%
Issuer Reporting / Audit & Accounting	92	21%	79	16%	95	21%	93	20%
Broker Dealer	38	9%	63	13%	53	12%	61	13%
Insider Trading	30	7%	51	10%	41	9%	45	10%
Market Manipulation	30	7%	32	6%	41	9%	30	6%
FCPA	18	4%	13	3%	13	3%	21	5%
Public Finance Abuse	14	3%	15	3%	17	4%	13	3%
Miscellaneous	5	1%	8	2%	10	2%	13	3%
Totals	**431**	**100%**	**490**	**100%**	**446**	**100%**	**464**	**100%**

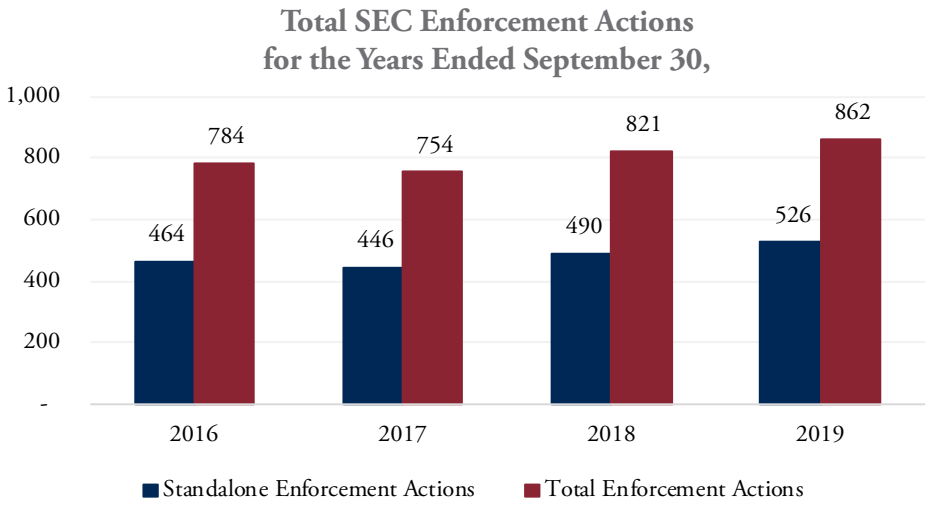
The SEC Reported an Increase in Standalone Enforcement Actions

Per the SEC's Annual Report, FY 2019 observed a nearly 7% increase in standalone enforcement actions compared to FY 2018. Across all enforcement actions observed in FY 2019, the Commission obtained judgments and orders totaling more than $4.3 billion, and nearly $1.2 billion was returned to harmed investors.

"We are actively looking for circumstances where an adviser is financially conflicted by incentives that could affect investment recommendations to clients. When we find those circumstances, we are asking: Has the adviser explained the conflict to the client? Does that explanation cover how the conflict may affect the recommendation? Does the client have sufficient information to make an informed decision? And I will tell you: the more we look, the more undisclosed or inadequately disclosed financial conflicts we find."

Stephanie Avakian, Co-Director, Division of Enforcement, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference, London, England, Nov. 5, 2019

2 It is also important to note the United States federal government shutdown for 35 days (between December 22, 2018 and January 25, 2019), the longest U.S. government shutdown in history, which may have impacted the number of standalone enforcement actions brought by the SEC as most SEC employees and contractors were furloughed and unable to work during this period.

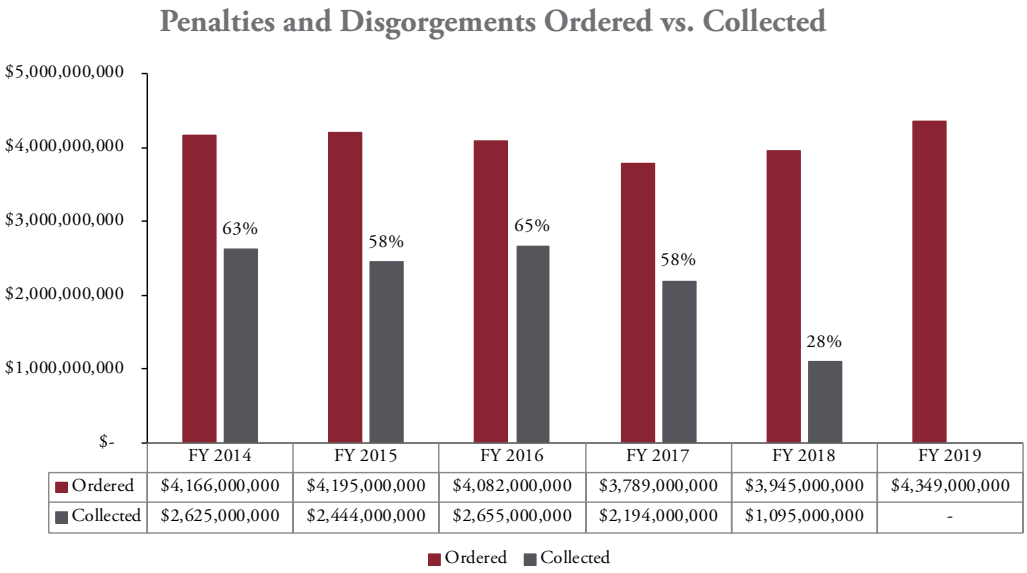


The SEC Collection Struggle Continues in FY 2018

"It is important that we continue our work to modernize our rules to provide better safeguards together with choice and opportunity to investors. The Division has sought to be transparent about its agenda to facilitate public input."

Dalia Blass, Director, Division of Investment Management, Keynote Address-2019 ICI Securities Law Developments Conference, Washington D.C. Dec. 3, 2019

The chart below reflects the SEC's ability to convert amounts due into cash over the five previous fiscal years, and, importantly, highlights the SEC's collection struggle in FY 2018, with only 28% of ordered penalties and disgorgements collected to date. Furthermore, the SEC has failed to collect more than 65% of penalities ordered in any of the previous five fiscal years, which raises the question: why is the SEC struggling to collect penalties and disgorgements? Are companies filing bankruptcy as a result of the penalites and disgorgements levied or are they actively finding ways to circumvent the fines? This will be a topic we follow closely in 2020. Please note, the SEC has not yet released FY 2019 collection data.



	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Ordered	$4,166,000,000	$4,195,000,000	$4,082,000,000	$3,789,000,000	$3,945,000,000	$4,349,000,000
Collected	$2,625,000,000	$2,444,000,000	$2,655,000,000	$2,194,000,000	$1,095,000,000	-

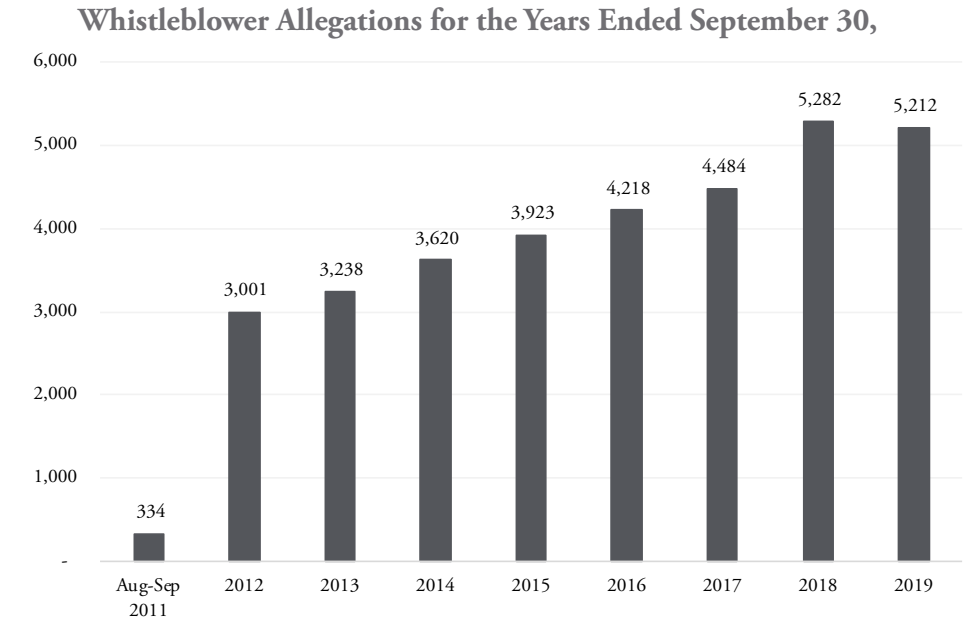
Kokesh's Impact on Funds Returned to Investors

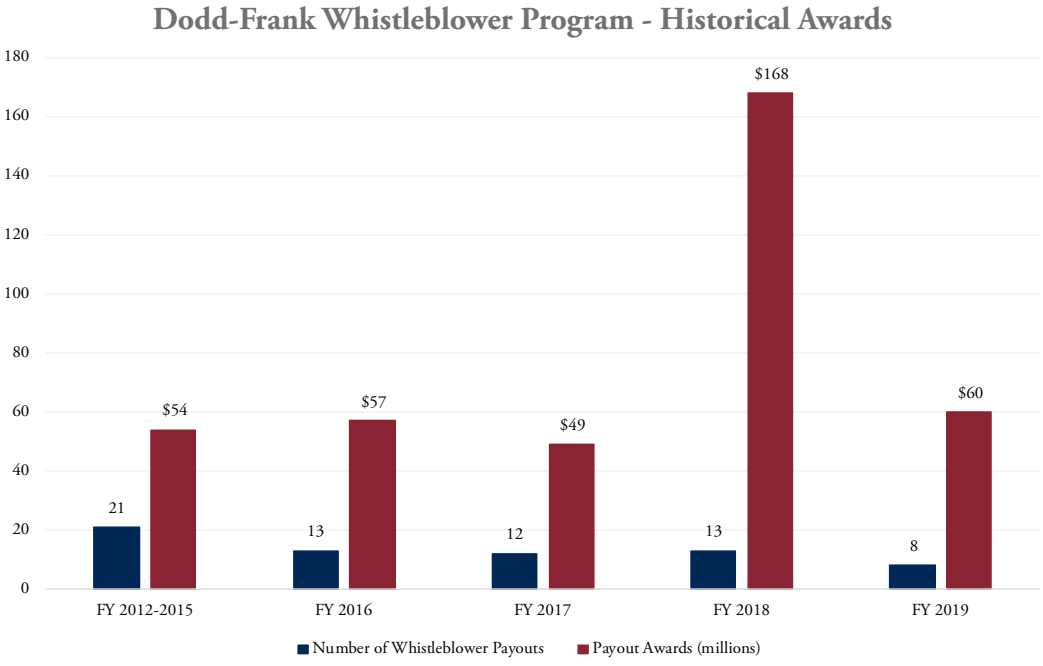
The Supreme Court's June 2017 decision in Kokesh vs. SEC continues to negatively impact the Commission's ability to disgorge and return funds to harmed investors injured by long-running frauds. More specifically, in Kokesh, the Supreme Court held that the Commission's claims for disgorgement are subject to a five-year statute of limitations period, which has significantly hindered the Commission's monetary collections. Per the SEC's annual report, the impact of the Supreme Court decision has caused the Commission to forgo approximately $1.1 billion in disgorgement in filed cases, or about 25% of all penalties and disgorgements ordered in FY 2019. Most notably, the Supreme Court's ruling in Kokesh may have a more consequential impact

in FY 2020, as the Supreme Court has agreed to consider whether the SEC has the authority to seek disgorgement at all – a question raised in Kokesh, but not explicitly addressed by the Court.

Whistleblower Awards Continue but Do the Benefits Justify the Costs?

In FY 2019, the SEC's Office of the Whistleblower ("OWB") received a total of 5,212 allegations. This is approximately 33% higher than the number of allegations received in FY 2015, however, it represents a slight decrease from FY 2018, the first year-over-year decrease since the program started in 2011. The charts below illustrate the growth in whistleblower allegations for the nine years ended September 30, 2019 and present a breakdown of awards paid since the program's inception.





"The SEC's Enforcement Division has approximately 1,400 employees and contractors. The Commission annually receives around 20,000 tips, complaints, and referrals, and this number continues to grow each year. Our staff finds other violations on its own, and we get self-reports. Matters take a long time to investigate and develop into an enforcement action. In a report released last month, the SEC's Office of Inspector General ("OIG") reported that for fiscal year 2018, 'the average number of months between opening a matter under inquiry or investigation and commencing an enforcement action was 25 months.' Given all these numbers, basic math makes clear that we at the Commission do not have the resources to tackle every potential securities law violation."

Commissioner Hester M. Peirce, Commissioner of the Securities and Exchange Commission, Remarks before the 51st Annual Institute on Securities Regulation, New York, NY, Nov. 4, 2019

Since the program's implementation in August 2011, the SEC has received over 33,000 allegations; yet, despite this enormous figure, the Whistleblower Program has granted only 67 awards (or 0.2% of allegations). According to the SEC's annual report, individuals are eligible for awards when the information provided results in either the opening of an investigation or an examination, or the opening of a new line of inquiry in an existing investigation or examination.

Therefore, one could interpret the low allegation to reward conversion rate in several ways: 1) the vast majority of allegations submitted to date have been of little significance to the SEC's investigations, or 2) the SEC has failed to sufficiently follow-up on allegations, which may not be surprising given the number of allegations received in FY 2019 (5,212) exceed the number of domestic companies listed on major U.S. exchanges (4,397) per the World Bank, or 3) investigations take several years to complete and whistleblowers are only rewarded once investigations are finalized and appeals are exhausted, which may mean there are a significant number of awards in the pipeline. There are, however, insufficient facts disclosed to refine this assessment.

Nevertheless, a noteworthy trend, as observed in the graphs above, is recipients of awards and payouts dropped precipitously in FY 2019 as compared to FY 2018, while the number of allegations only dipped slightly. This may highlight the difficulties faced by the SEC in successfully prosecuting individuals and companies based on allegations received through the Whistleblower Program or it may be indicative of the timing differences between when allegations are made and when awards are ultimately disbursed.

"The SEC's enforcement program effectively serves American investors and the capital markets that underpin the broader economy."

Commissioner Hester M. Peirce, Commissioner of the Securities and Exchange Commission, Remarks before the 51st Annual Institute on Securities Regulation, New York, NY, Nov. 4, 2019

Based on these facts, it may be time for the SEC to consider a cost-benefit analysis to assess whether the benefits from the tips and allegations received warrant the invested effort and costs. To perform a fulsome cost-benefit analysis, the SEC would need to consider payroll costs and labor efforts associated with the program, including the creation of the OWB, and compare those costs to the number of awards to whistleblowers and the net cash received based on whistleblower tips, among other considerations. Furthermore, the analysis would need to consider whether the allegations would have been uncovered through different investigatory means and include an estimate of the financial impact of claims that may not be identifiable from different sources. It's important to also note that any cost-benefit analysis should factor in the potential deterrent effects (i.e., are people less likely to commit a fraud because of the program).

Non-Monetary Relief Obtained

In addition to monetary relief (disgorgement and penalties) pursued by the Commission, the Commission can also enforce non-monetary remedies against individuals and companies involved in enforcement actions. Examples of non-monetary remedies include undertakings, imposing bars or suspensions, trading suspensions, and court-ordered asset freezes.

When the SEC imposes an undertaking in response to an enforcement action, the defendants in the action must take affirmative steps such as retaining a compliance consultant. In practice, undertakings are one of the most effective forms of relief imposed by the Commission. One example of an undertaking in 2019 involves KPMG's violations of ethics and integrity requirements surrounding training examinations. As a result of the enforcement action, the company had to conduct an ethics and integrity training for all audit professionals and had to retain an independent consultant to attest to the ethics and integrity efforts of the company.

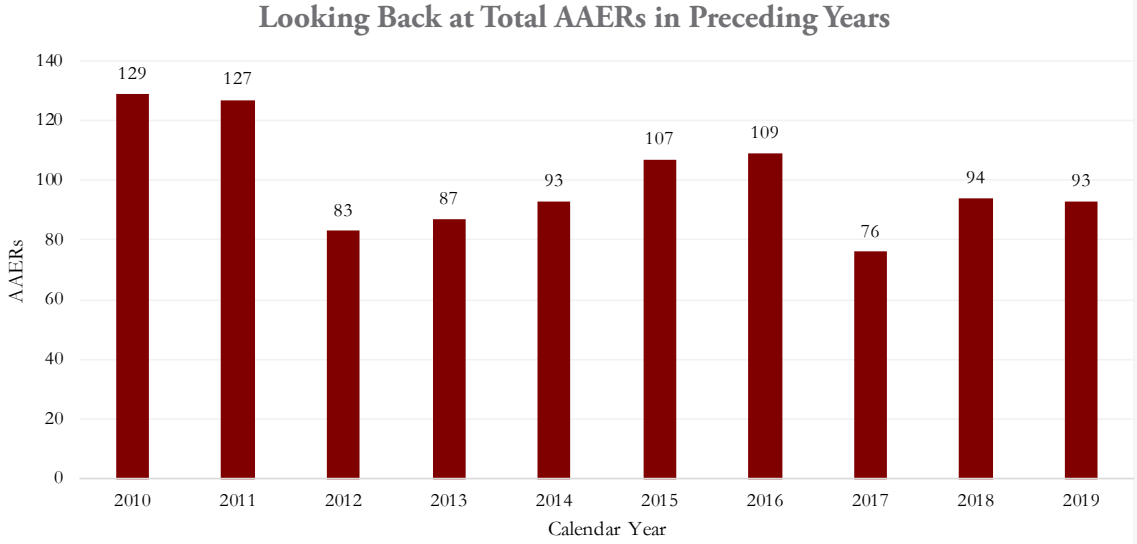
When the SEC imposes bars or suspensions, they prohibit wrongdoers from serving in public companies, from associating with registered entities, or from appearing or practicing before the Commission. In FY 2019, enforcement actions resulted in 595 bars and suspensions, a slight increase from the 550 bars and suspensions in FY 2018.

Similarly, the SEC can impose trading suspensions which prevent wrongdoers from trading any stock for up to ten trading days in order to protect investors' interests. The Commission imposed 271 and 280 trading suspensions in FY 2019 and FY 2018, respectively.

Lastly, the SEC can enforce court-ordered asset freezes which prevent wrongdoers from hiding and/or transferring assets abroad. Notably, for this type of non-monetary relief to be effective, the wrongdoing must be detected early, and the asset freeze must be expedited. As a result of enforcement actions in FY 2019, the SEC imposed 31 asset freezes, as compared to 26 in FY 2018.

AAERs for the Twelve Months Ended December 31, 2019: Major Observations and Insights

For the twelve months ended December 31, 2019, the SEC issued 93 AAERs, representing a slight decrease of 1% in releases from 2018 to 2019.

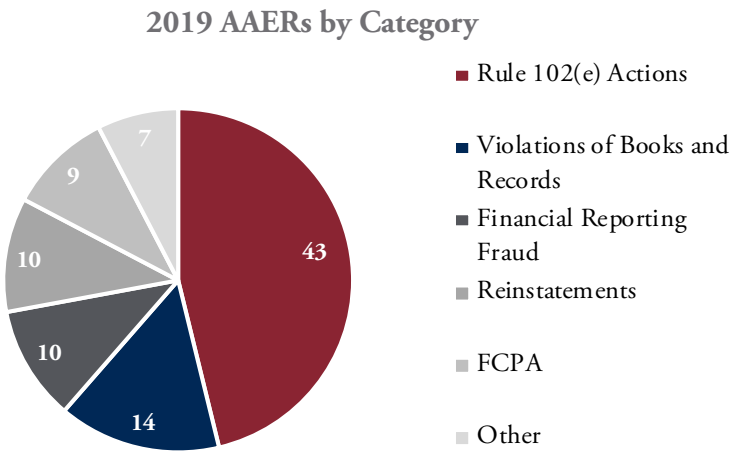


AAERs highlight enforcement actions related to auditing and accounting matters and the SEC determines whether each enforcement release is categorized as an AAER. In 2019, AAERs comprised 11% of all enforcement actions, which is consistent with 2018 results.

To evaluate the type of enforcement action behind each AAER issued in 2019, we sorted the releases into six major categories: Rule 102(e) Actions, Financial Reporting Fraud, FCPA, Reinstatements, Violations of Books and Records, and Other. The chart below illustrates the number of AAERs in each category in 2019.

"The SEC's Division of Enforcement leads our efforts to punish those who mistakenly think they can get away with wrongdoing. Just last week, we announced that we filed an emergency action and obtained an asset freeze against the operators of a South Florida-based investment scheme that defrauded over 100 retail investors, many of whom are seniors."

Commissioner Elad L. Roisman, Commissioner of the Securities and Exchange Commission, Remarks at the Elder Justice Coordinating Council Fall 2019 Meeting, Washington D.C., Dec. 3, 2019



Within the AAERs, nearly half of the actions brought forth by the SEC in 2019 related to suspensions or disbarments from practicing before the SEC under Rule of Practice 102(e). These can be temporary or permanent and can be levied against either an individual working at a firm or against the firm as a whole.

"Our enforcement program is not a set of data points. Instead, our program consists of the judgments made by a group of hard-working, experienced, bright attorneys, accountants, economists, paralegals, data analysts, computer experts, and support staff dedicated to safeguarding the integrity of our markets."

Commissioner Hester M. Peirce, Commissioner of the Securities and Exchange Commission, Remarks before the 51st Annual Institute on Securities Regulation, New York, NY, Nov. 4, 2019

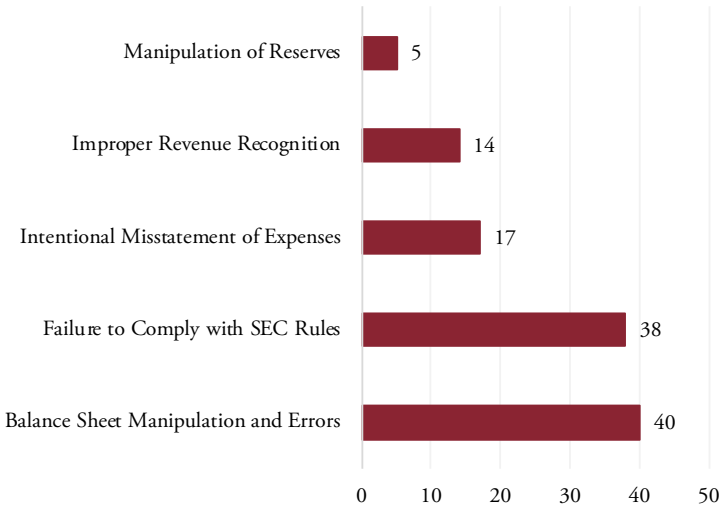
The 2019 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in the 2019 AAERs, we identified the accounting problem(s) in each based on the classification definitions below.

Classification	Definition
Manipulation of Reserves	Improperly created, maintained, or released reserves and other falsified accruals
Improper Revenue Recognition	Overstated, premature, and fabricated revenue transactions reported in public filings
Intentional Misstatement of Expenses	Deceptive misclassifications and misstatements of expenses
Failure to Comply with SEC Rules	SEC filing offenses and financial disclosure errors, omissions, or otherwise misleading representations
Balance Sheet Manipulation and Errors	Misstatement and misrepresentation of asset balances and the recording of transactions inconsistent with their substance

As shown below, failure to comply with SEC rules represents the most common financial reporting issue in the 2019 AAER population. Importantly, we record each accounting problem identified in a release as a separate item. Therefore, many actions that involve improper revenue recognition, manipulation of reserves, and the intentional misstatement of expenses also have a balance sheet impact. For this reason, we do not consider the category of balance sheet manipulation and errors in our ranking of issues.

Financial Reporting Issues Identified in 2019 AAERs

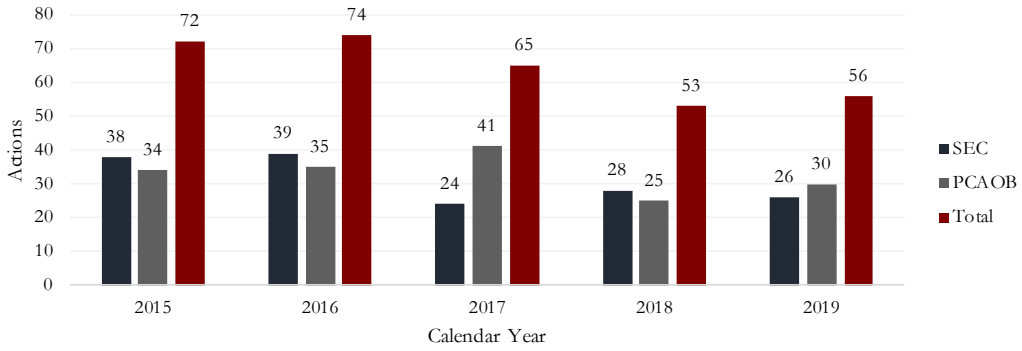


Failure to comply with SEC rules continues to represent an issue of increasing prominence in 2019, constituting 33% of the financial reporting issues identified in this year's AAERs. The majority of these issues relate to public filings that did not meet the auditor independence requirements, and therefore do not meet the SEC's filing requirements. Of note, also included in this category are errors, omissions, and misstatements related to MD&A, non-GAAP measures, and key performance indicators in public filings and financial statements.

SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions

The SEC and PCAOB share the responsibility of taking action against auditors who violate SEC rules and professional standards. In 2019, the PCAOB reported a 20% increase in auditing-related enforcement and disciplinary actions as compared to 2018, which is contrasted by a 7% decrease in auditing-related enforcement actions reported by the SEC during the same time frame. Most notably, between 2015 and 2019, we observe an average decrease of approximately 5% year-over-year in combined auditing-related enforcement actions taken by the SEC and PCAOB.

SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions



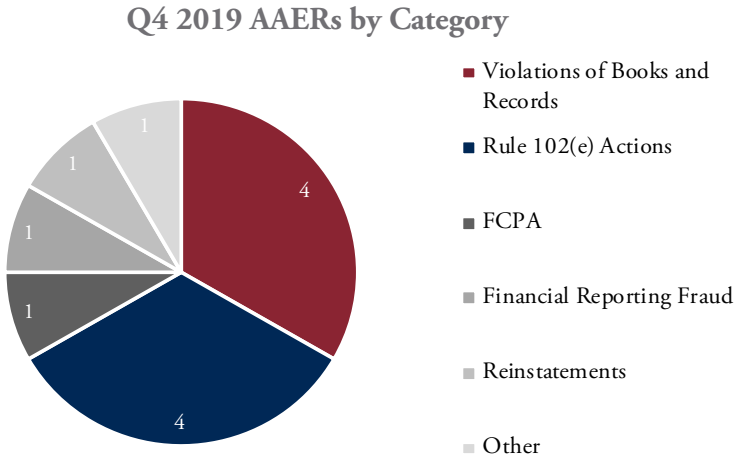
"The PCAOB plays an important role in the financial reporting system. Investors expect and deserve financial information that is complete and accurate. The independent audit is a critical addition to an investor's confidence in the completeness and accuracy of information within the financial statements."

Sagar Teotia, Chief Accountant, Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments, Washington D.C., Dec. 9, 2019

Overview of Q4 2019 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 chart below illustrates the number of AAERs that fell into each category of violation during the fourth quarter of 2019. Violations of Books and Records and Rule 102(e) Actions led the releases in the fourth quarter, each accounting for 33% of the total.



Notable Q4 2019 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.

Accounting and Auditing Enforcement Release No. 4102 / November 25, 2019, Administrative Proceeding File No. 3-19607, In the Matter of Calumet Specialty Products Partners, L.P., Respondent.

The SEC recently settled an action through a cease and desist order against Calumet Specialty Products Partners, L.P. ("Calumet"), related to reporting misleading financial results in a quarterly press release. Calumet is a producer of specialty hydrocarbon products, headquartered in Indianapolis, Indiana. The facts for the action are described in the SEC's AAER.

What's most notable about the case is that Calumet seemed far from ready to issue its financial results when it released misstated financial results for the year ending December 31, 2017 ("2017 Financial Results") in its March 2018 earnings release; yet no one stopped the release. Per the AAER, Calumet issued the results in response to significant pressure from investors.

Needless to say, Calumet's corporate governance system and disclosure controls failed to stop the company from releasing the flawed results, raising questions about the responsibilities of those involved, including management, the board of directors and the audit committee. Of significance, the release highlights the pressures on ordinary governance roles when a public registrant is dealing with financial reporting stress.

The following discussion provides an overview of the facts from the AAER, the roles of the key participants with regard to the release of the results, an assessment of each participants' responsibilities and, importantly, suggestions for legal counsel to help registrants avoid similar problems.

Overview of Calumet's Reporting Failure

Calumet's reporting failure occurred following their systems problems, turnover of key personnel, a prior filing delay, and known internal control weaknesses. Any one of these situations would present material challenges for a public registrant's financial reporting function, while the combination creates a recipe for failure unless the situation is tightly managed.

Calumet's systems problems were disclosed in its financial statements for the quarter ended September 30, 2017. In this filing, the company described problems with its implementation of a new enterprise resource planning ("ERP") system that resulted in various "operating and reporting disruptions, including limitations on [Calumet's] ability to ship product and bill customers, project [its] inventory requirements, manage [its] supply chain, maintain current and complete books and records, maintain an effective internal control environment and meet external reporting deadlines."

Adding to Calumet's systems problems, three senior finance and accounting managers, including the company's interim controller, resigned during the fourth quarter of 2017. The combination of the systems problems and the turnover of key personnel likely also caused the third quarter filing to be seven weeks late and reported internal control weaknesses for failure to exercise sufficient corporate governance and failure to design effective controls over the ERP implementation.

Per the AAER, Calumet's investors, concerned that Calumet would not be able to disclose its year end 2017 financial results ("2017 Financial Results") on time, began pressuring the company to issue its earnings release in early March, consistent with the time frame Calumet achieved in prior years. Complicating matters, Calumet's auditors advised the company on March 1, 2018 that its problems with closing of the books and records warranted another internal control weakness disclosure.

Yet, despite the stresses on its financial reporting function, Calumet acquiesced to the investors' pressures and issued an earnings release on March 8, 2018, announcing the company's 2017 Financial Results. However, on March 19, 2018, Calumet disclosed that its earnings release from March 8, 2018 was inaccurate. As a result, Calumet's shares declined over 8% that day.

Subsequently, on April 2, 2018 Calumet filed its 2017 Annual Report, reporting materially different results from what had been reported in the March 8, 2018 earnings release. In its corrected results, Calumet reported 2017 earnings before interest, taxes, depreciation, and amortization ("EBITDA") that was $18.7 million lower (approximately 7.6%), and a net loss that was $18.7 million greater (approximately 18%) than what it reported on March 8, 2018. According to the AAER, Calumet's errors directly related to problems with the company's ERP implementation and other internal control weaknesses.

"High-quality financial statements, prepared in accordance with a framework developed by independent standard setters, provide relevant and reliable information to investors. Audits of financial statements performed by independent accountants increase the credibility of the financial statements…Preparers, audit committees, auditors, standard setters, regulators, and others all play different but interconnected roles in the process designed to provide high-quality financial information to investors. Ultimately, the strength of our financial reporting system relies on the rigor applied to each of its component parts."

Sagar Teotia, Chief Accountant, Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments, Washington D.C., Dec. 9, 2019

To assess who bore the greatest responsibilities to stop the flawed earnings release from being issued involves assessing both traditional roles and responsibilities, as well as how those roles may shift when under the stresses described above.

Management

Importantly, management carries the primary responsibility to prepare a company's financial statements and present the company's financial condition and results of operations along with presenting proper disclosures. This responsibility includes establishing and maintaining the company's internal controls over financial reporting and the company's disclosure controls and procedures.

From simply reading this definition, one may quickly conclude that management bears the greatest responsibility for the issuance of the flawed earnings release. However, the SEC's release reveals numerous problems at the company that should have put the board of directors and audit committee on high alert to exercise their oversight functions in the most cautious manner.

Board of Directors

"When our markets evolve and the volume and nature of information available to market participants' changes, the valuation inputs, assumptions, or even the techniques a fund utilizes may also change. Both effectiveness and efficiency, or said in other words, quality and innovation, are important to getting it right, and developments in data and analytics have changed how these are achieved."

Alison Staloch, Chief Accountant, Division of Investment Management, Remarks to the Greater Cincinnati Mutual Fund Association, Cincinnati, OH, Dec. 3, 2019

The board of directors oversees the company's management and business strategies. While board of directors delegate the responsibility for operating the company's business to senior management, boards are responsible for oversight of a company's activities. Importantly, boards need to be adequately informed in order to fulfill their oversight role related to the company's financial statements, a critical consideration when dealing with company crises. Of significance, the distinction between oversight and assisting in management can be blurred during such crises and when boards engage in major decisions.

In defense of Calumet's board of directors, in the ordinary course, it would be justified in fulfilling its oversight role by inquiring of management if the earnings release was fairly stated and ready for issuance. However, when reading the extent of the company's reporting problems, and knowing the audit was still underway, it does appear there were sufficient grounds for the board of directors to challenge management's judgments and stop the issuance of the earnings release.

The board of directors' assessment in this situation would be led by the audit committee, which is the subset of the board that provides expertise on financial reporting matters and is comprised of board members who meet financial literacy standards, including one or more committee members who qualify as audit committee financial experts.

Presumably, Calumet's full board of directors relied on its audit committee in forming its judgments, so let's consider the role of the audit committee for the faulty earnings release.

Audit Committee

On behalf of the board of directors, the audit committee should be aware of significant issues relating to the company's financial statements, discuss the issues with management, and be in control of the outside auditor relationship. Audit committees should review earnings releases prior to their issuance.

It is important that the audit committee is satisfied that the financial statements and other disclosures prepared by management fairly present the company's financial condition and results of operations. The audit committee also oversees the company's

system of internal controls over financial reporting and should be knowledgeable of any significant deficiencies or material weaknesses in internal controls and apprised of action plans for corrections and improvements.

Overall Assessment

Unfortunately, we only have the facts presented in the SEC's release, and additional facts may change our assessment, including the advice and/or consultation with the independent auditor. That said, even recognizing management's primary responsibility for the financial statements, the audit committee, as the board's financial and accounting experts, seems to bear the greatest responsibility to have stopped the flawed results from being issued. The combination of the finance function turnover, internal control weaknesses, and ERP systems problems, plus the apparent unfinished audit procedures as of the issuance date, would present such significant risks that the audit committee should have advised the board of directors that a delay would be necessary. Even though this assessment is made with the benefit of hindsight and knowledge of the flawed results, one should not deliver financial results to the market at anything less than a full confidence level.

Suggestions for Legal Counsel

The SEC's enforcement action doesn't mention the role of legal counsel for the company, board of directors or audit committee, even though one would expect each had legal representation. Suggestions for legal counsel to pursue under similar circumstances include:

- Interview staff personnel in the financial reporting function as to the completeness of their efforts, major open items and their comfort level in the financial information presented as of the earnings release date;
- Inquire whether company officers sign the equivalent of Section 302 of the Sarbanes-Oxley Act of 2002 certifications which require that the information presented in the earnings release is accurate and complete and that management has established and maintained adequate internal controls for public disclosures;
- Assist the audit committee in discussions with the independent auditors regarding the status of their audit, open issues, ongoing internal review processes, and importantly, estimated date for completion;
- Inquire of public relation and communication specialists regarding comparable delayed messaging;
- Formally report to the company on the legal, regulatory and financial consequences of the earnings release delay, versus the risks of prematurely issuing an earnings release that may be erroneous; and
- Finally, engage financial reporting experts who can assist and advise on the readiness of the financial information and risks created by the control failures.

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ACKNOWLEDGEMENT
We wish to acknowledge the valuable contribution to this analysis by Patricia L. Guggiari and Jacob Lee.

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ABOUT Floyd Advisory
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