



*Summary of Accounting and  
Auditing Enforcement Releases  
for the Year Ended  
December 31, 2020*

ANNUAL REPORT 2020

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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, 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 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  
JANUARY 2021

# Highlights:

- SEC enforcement actions decreased 17% from 862 in Fiscal Year (“FY”) 2019 to 715 in FY 2020, consistent with a 23% decrease in standalone enforcement actions (i.e., civil actions or administrative proceedings excluding proceedings against delinquent filers and follow-on proceedings to obtain bars or suspensions) from 526 in FY 2019 to 405 in FY 2020. Despite this observed decline, the SEC launched initiatives such as the Coronavirus Steering Committee (“CSC”), obtained record-breaking monetary remedies, and had significant wins before juries and in contested administrative and cease-and-desist proceedings in FY 2020.
- The Dodd-Frank Whistleblower Program issued the largest award since the program’s inception – over \$114 million to a single whistleblower in October 2020. Furthermore, FY 2020 marked a record year in terms of awards issued, accounting for approximately 37% of all individuals awarded since the program’s inception in 2011. FY 2020 was also a record-breaking year for the number of whistleblower tips received, as the Commission recorded 6,911 tips in FY 2020 alone, up 33% from FY 2019.
- The prominence of Rule 102(e) Actions continued, with the category accounting for 42% of total AAERs in FY 2020 and for 59% of AAERs in Q4 2020 alone. FY 2020 also marked the highest number of Financial Reporting Fraud actions released by the Commission over the past five years, accounting for 19% of all AAERs in FY 2020.
- In our “Recommended Reading” section, we discuss the case involving Belden Inc., which raises numerous lessons for public registrants and their advisors, including the importance of adequately addressing internal control issues raised by acquisition due diligence procedures, assessing the pros and cons inherent in bill and hold transactions, and ensuring “know your customer” programs are in place.

## 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](http://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). Of 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, 2020

## *The SEC's Ongoing Focus on COVID-related Challenges to Preserve the Integrity of the Markets*

When the global pandemic was declared in March, the Commission devoted significant time and resources to face the challenges brought on by COVID-19. In particular, the SEC formed the Coronavirus Steering Committee to coordinate investigations in the areas of microcap, insider trading, financial fraud, and issuer disclosure. This effort also allowed the Division of Enforcement to quickly identify and recommend trading suspensions to the Commission. In March and April alone, the Commission suspended two dozen issuers for violations related to the accuracy and adequacy of COVID-19 related disclosures. The Division of Enforcement also opened more than 150 COVID-related inquiries and investigations and recommended numerous COVID-related fraud actions for the Commission to pursue. Nevertheless, despite the Commission's significant efforts to investigate COVID-related actions, the SEC only filed 715 enforcement actions in FY 2020, constituting a 17% decrease in the number of actions filed when compared to FY 2019 and representing the lowest number of actions filed since FY 2013, when the Commission filed 676 actions. Of significance, 72% of the Commission's standalone enforcement actions in FY 2020 resulted in charges against one or more individuals, including numerous CEOs, CFOs, accountants, auditors, and other gatekeepers.

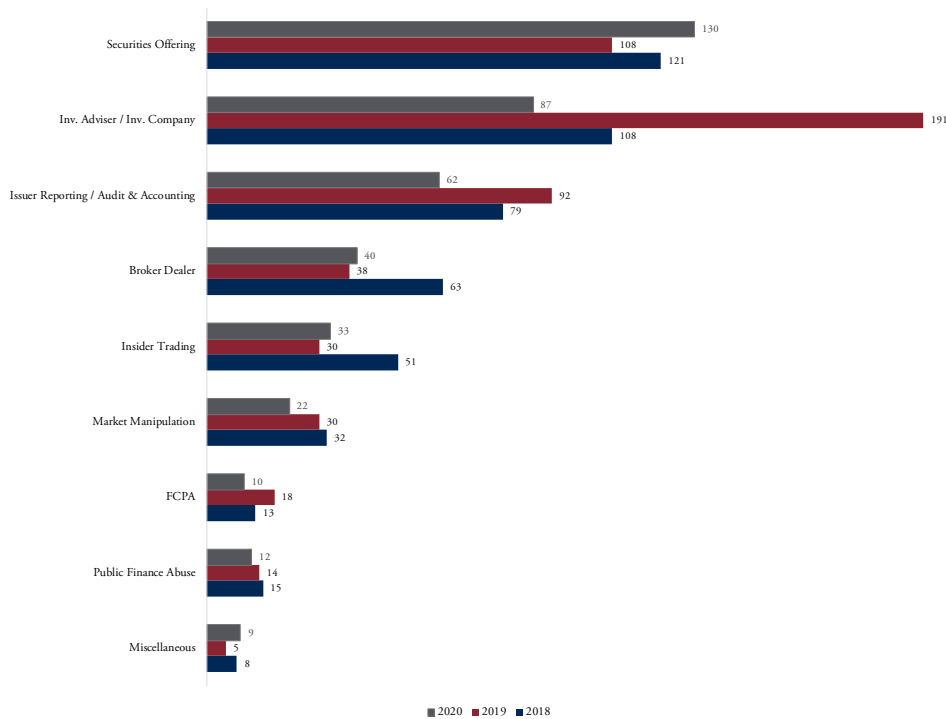
"I am pleased to report that while the pandemic significantly impacted *how we do our work*, it did not negatively impact the work itself. Our planned oversight, examination, rulemaking, and enforcement work continued with vigor, rigor and transparency."

Chairman Jay Clayton,  
An Update on FY 2020 Results:  
Remarks at SEC Speaks,  
Washington D.C.,  
October 8, 2020

Furthermore, the Division focused on improving several key areas, including addressing whistleblower allegations, making distributions to harmed investors, assessing the pace of investigations, and communicating the benefits of cooperating with investigations. In FY 2020, the Commission awarded \$175 million in whistleblower awards to 39 individuals, representing a 200% increase in the number of individuals who received an award when compared to previous record years, FY 2016 and FY 2018. The Commission also distributed over \$600 million to harmed investors and focused on shortening the amount of time it takes to complete investigations and recommend actions. Further, the Commission emphasized the importance of filing actions as close in time to the misconduct as possible. To achieve these results, the Commission focused on increased staffing, worked to more efficiently triage issues, made more targeted requests, engaged early in investigations with relevant parties, and leveraged cooperation. While the full impact of the pandemic has yet to be determined, the Commission was able to reduce the average time it takes to complete an investigation from 37 months down to 34 months and achieved a five-year low of 21.6 months for the median time it takes to file an action. Amid all of the COVID-related challenges, the Commission continues to seek ways to accelerate the pace of investigations and anticipates additional improvements in both the near- and long-term.

A review of the types of enforcement actions recommended by the Division of Enforcement in FY 2020 suggests the Commission placed increased scrutiny on securities offering violations, which increased 20% from FY 2019 and accounted for 32% of the total standalone enforcement actions for the year. On the other hand, issuer reporting / audit & accounting actions observed a 33% decrease in FY 2020, representing the lowest number of actions filed in this category since FY 2016, possibly highlighting a shift in the Commission's near-term focus.

## Standalone Enforcement Actions by Classification FY 2018 to 2020



Standalone Enforcement Actions										
Classification	FY 2020		FY 2019		FY 2018		FY 2017		FY 2016	
	#	%	#	%	#	%	#	%	#	%
Securities Offering	130	32%	108	21%	121	25%	94	21%	90	19%
Inv. Adviser / Inv. Company	87	22%	191	36%	108	22%	82	19%	98	21%
Issuer Reporting / Audit & Accounting	62	15%	92	17%	79	16%	95	21%	93	20%
Broker Dealer	40	10%	38	7%	63	13%	53	12%	61	13%
Insider Trading	33	8%	30	6%	51	10%	41	9%	45	10%
Market Manipulation	22	5%	30	6%	32	6%	41	9%	30	6%
FCPA	10	3%	18	3%	13	3%	13	3%	21	5%
Public Finance Abuse	12	3%	14	3%	15	3%	17	4%	13	3%
Miscellaneous	9	2%	5	1%	8	2%	10	2%	13	3%
<b>Totals</b>	<b>405</b>	<b>100%</b>	<b>526</b>	<b>100%</b>	<b>490</b>	<b>100%</b>	<b>446</b>	<b>100%</b>	<b>464</b>	<b>100%</b>

In addition to the 715 enforcement actions brought forth in FY 2020 (405 of which were standalone actions), the Commission also obtained over 475 bars or suspensions, opened approximately 1,200 inquiries and investigations, received and triaged approximately 23,650 tips, complaints, and referrals, conducted countless remote interviews, testimonies, and depositions, and conducted, and won, one virtual trial. Overall, this highlights an important trend: while standalone enforcement actions brought by the SEC declined, the Commission focused its efforts on opening inquiries and investigations and on returning money to harmed investors, as evidenced by the approximately \$4.68 billion in disgorgement and penalties levied in FY 2020 – the highest amount on record, as detailed further below.

### *The SEC Reported a Decrease in Total Enforcement and Standalone Enforcement Actions*

As previously set forth, there was a 23% decrease in standalone enforcement actions in FY 2020 as compared to FY 2019 as well as a 17% decrease in total enforcement actions.

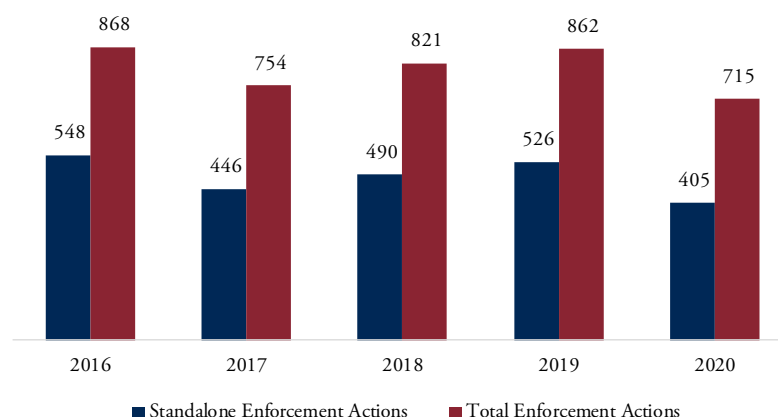
“Starting with the Division of Enforcement, the Commission brought over 700 actions in FY 20, a significant percentage of which were brought after March 15. The Commission obtained financial remedies of more than \$4 billion; an amount above that of last year.”

Chairman Jay Clayton,  
An Update on FY 2020 Results:  
Remarks at SEC Speaks,  
Washington D.C.,  
October 8, 2020



Following a sustained increase in the number of filed enforcement actions between FY 2017 and FY 2019, FY 2020 represented the lowest number of enforcement actions since FY 2013. While this decline could be attributed to COVID-related uncertainties, it is also important to consider the impact of the highly-contentious U.S. presidential election in 2020. To that end, we reviewed the Division of Enforcement's annual reports in FY 2012 and FY 2016, the most recent U.S. presidential election years, and noted the number of actions brought by the SEC in 2012 decreased by less than 1% and increased by only 5% in 2016. Given this trend, it is not clear what impact, if any, the U.S. presidential election had on the SEC's enforcement efforts in FY 2020.

### Total SEC Enforcement Actions for the Years Ended September 30,



**“By the way, we set records for amounts of financial remedies ordered in 2019 and 2020, and the approximately \$3.5 billion we returned to harmed investors since 2017 substantially outpaces the amount returned during the prior three-year period.”**

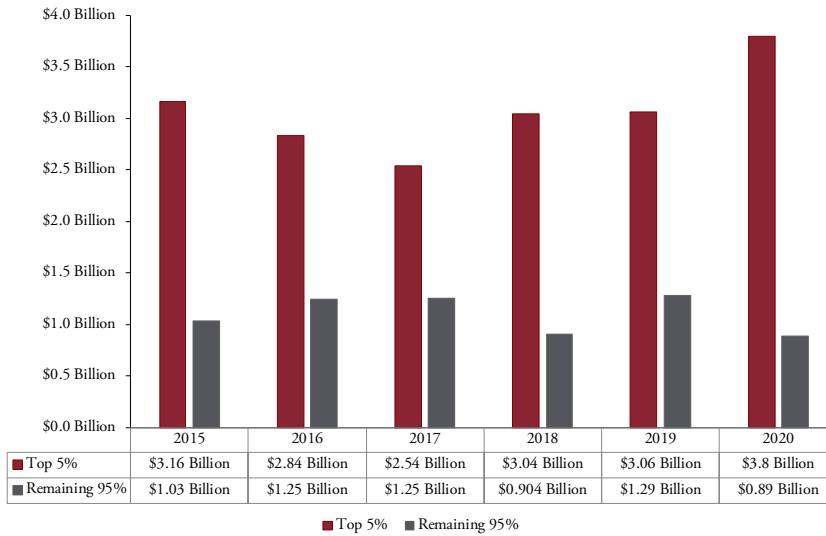
Chairman Jay Clayton, Putting Principles into Practice, the SEC from 2017-2020: Remarks to the Economic Club of New York, November 19, 2020

While quantitative measures are an important consideration, the Commission also notes that a review of the nature and quality of enforcement actions, and a thorough understanding of the market conditions in which they occurred, should also be considered when assessing performance. Accordingly, the Commission initiated new enforcement efforts including, for example, the Coronavirus Steering Committee which allowed the Commission to centralize and coordinate investigations related to COVID-19. The CSC ensured the Commission had a consistent approach to coronavirus-related matters, appropriately allocated resources, and coordinated with state and federal agencies. The CSC also issued an Investor Alert in February 2020 warning of potential COVID-19 related scams targeting retail investors. In addition, the Commission reported its first action arising from investigations generated by the Division of Enforcement's Earnings Per Share (“EPS”) Initiative, an initiative that utilizes risk-based data analytics to uncover potential accounting and disclosure violations caused by abusive earnings management practices.

### *The SEC Obtains Record-Breaking Monetary Remedies*

In FY 2020 the Commission ordered record-breaking monetary relief totaling \$4.68 billion, representing an approximate 8% increase over FY 2019. Within the Commission's actions and proceedings, parties were ordered to pay approximately \$3.59 billion in disgorgement of ill-gotten gains and the SEC imposed \$1.09 billion in penalties, resulting in \$330 million in additional monetary relief over FY 2019. Furthermore, in FY 2020, the largest 5% of actions accounted for 81% of financial remedies obtained by the Commission – the highest percentage over the previous five years. Lastly, the Commission returned approximately \$602 million to harmed investors, comprising over 800,000 individual payments.

## Total Money Ordered



### Key Focus Areas for Enforcement Actions

Beginning in late 2018, and continuing through FY 2020, the Commission focused on investigating violations at major financial institutions. The SEC's efforts resulted in enforcement actions against depository banks and brokers comprising the world's largest financial institutions and more than \$432 million in disgorgement and penalties. The Commission also brought actions against nationally recognized statistical rating organizations, addressing issues in the credit rating process.

Another focus area of the Commission was bringing enforcement actions against financial professionals who misappropriated material non-public information. For example, the Commission charged the senior manager of a globally recognized index provider for an insider trading scheme that generated more than \$900,000 in illegal profits.

Furthermore, in FY 2020 the Division of Enforcement concluded the Share Class Selection Disclosure Initiative. This initiative resulted in the SEC ordering nearly 100 investment advisory firms to return more than \$139 million to investors, with the vast majority of the initiative's activity being recorded in FY 2019.

It is also worth highlighting that the Commission had significant wins before juries, in bench trials, and in contested administrative and cease-and-desist proceedings in FY 2020, prevailing in all litigation that reached a verdict or decision this year.

### Whistleblower Record-Breaking Accomplishments

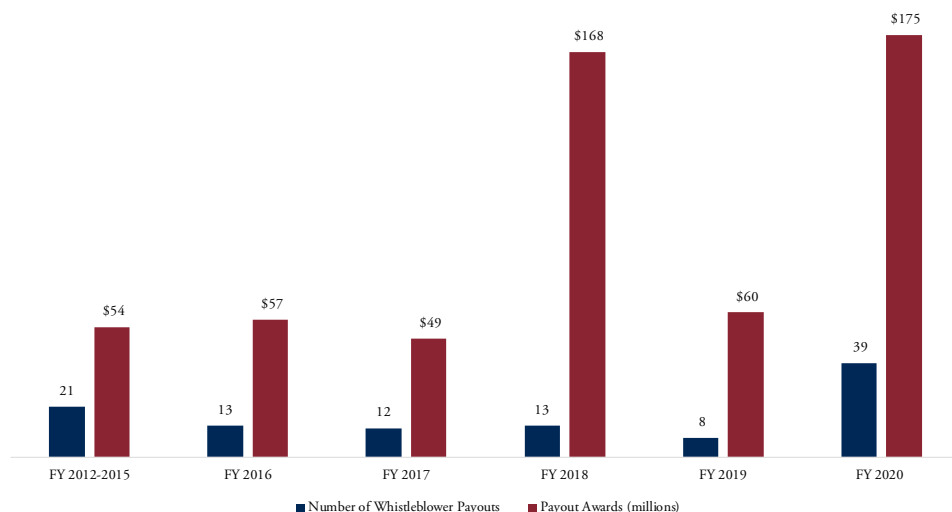
For the SEC's Office of the Whistleblower ("OWB"), FY 2020 was a record year. The number of individuals who received an award in 2020 account for approximately 37% of all individuals awarded since the inception of the program in 2011. The Commission's efforts to streamline whistleblower claims continue to yield sizable results, including record numbers of individuals awarded, dollars awarded, claims processed, and tips received. In FY 2020 alone, the Commission issued approximately \$175 million in awards to 39 individuals, crossing the \$500 million threshold of total amounts awarded since the program's inception. Of note, FY 2020 also represented the highest dollar amount awarded in the program's history, exceeding FY 2018, the previous record year, by approximately \$7 million. Among its new milestones, the Commission issued the largest award since the program's inception and awarded \$114 million to a single

**"What's more, the Commission awarded a record 39 individual whistleblowers approximately \$175 million — more, much more, than in any prior fiscal year."**

Chairman Jay Clayton,  
An Update on FY 2020 Results:  
Remarks at SEC Speaks,  
Washington D.C.,  
October 8, 2020

whistleblower in October 2020. Furthermore, in June 2020, the Commission issued another significant award of \$50 million to an individual who provided firsthand observations of misconduct by a company that resulted in a significant amount of money returned to harmed investors.

### Dodd-Frank Whistleblower Program - Historical Awards



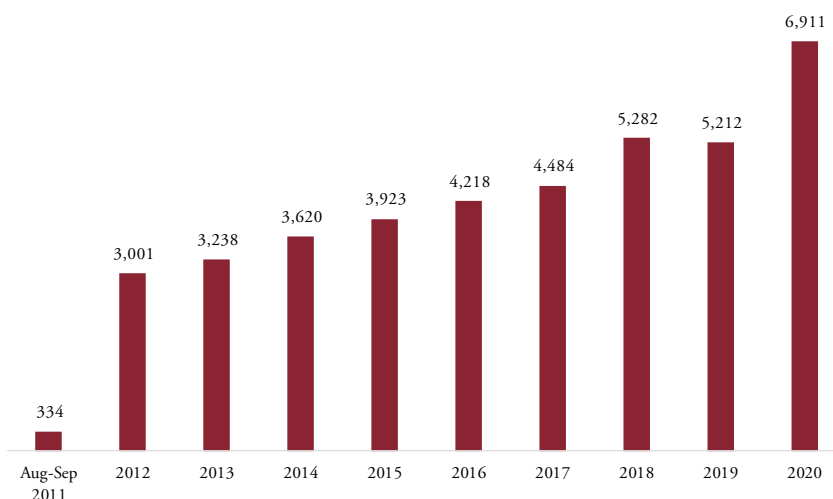
**“Particularly in times of heightened market volatility and uncertainty, the potential for executives to possess material non-public information increases, as we have witnessed during this time of COVID-19-induced economic and market stress.”**

Chairman Jay Clayton, Putting Principles into Practice, the SEC from 2017-2020: Remarks to the Economic Club of New York, November 19, 2020

Since the program’s inception, the SEC has received over 40,000 tips and allegations through its whistleblower hotline. In fact, in FY 2020 alone, the SEC received a record-breaking number of whistleblower tips – 6,911 – which constitutes a 33% increase from FY 2019. Most notably, the SEC received approximately 4,000 tips and allegations between mid-March and mid-May – 35% higher than the same period last year. Of significance, this uptick may be partially attributable to the remote working environment and COVID-related furloughs and layoffs, as whistleblowers feel more emboldened to submit tips in the privacy of their homes or may be less concerned about retaliation if they are not interacting regularly with their managers or if they have been furloughed or laid off.<sup>1</sup>

The types of misconduct reported by whistleblowers in FY 2020 were consistent with prior years in which corporate disclosures and financials, offerings fraud, and manipulation steadily ranked as the three highest allegation types, accounting for 25%, 16%, and 14%, respectively, in FY 2020.

### Whistleblower Allegations for the Years Ended September 30,



<sup>1</sup> <https://www.wsj.com/articles/tips-to-sec-surge-as-working-from-home-emboldens-whistleblowers-11591003800>.

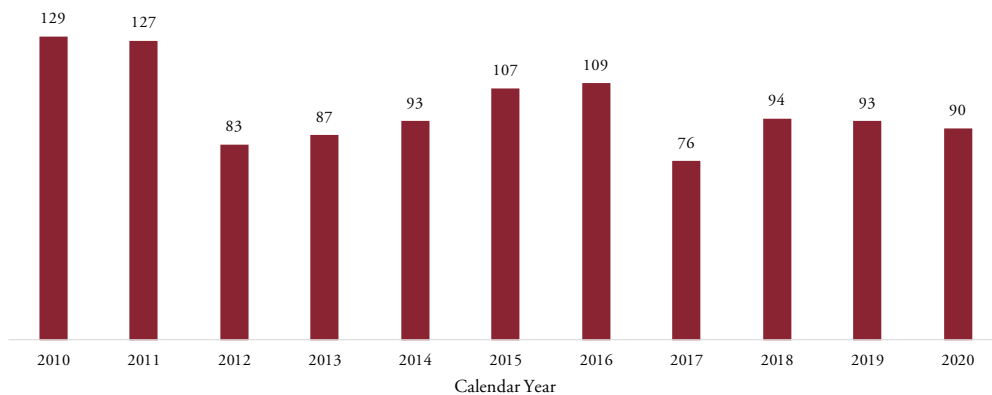


The Commission also issued substantially more preliminary determinations in FY 2020 – 315 – which represents a 167% increase from FY 2019. Following the initial review of a whistleblower claim, the OWB sets forth a preliminary assessment, including whether the claim should be approved or denied and, if approved, the proposed award amount. Given the Commission’s goal to process meritorious claims, the OWB prioritizes claims that appear to be eligible for an award.

## AAERs for the Twelve Months Ended December 31, 2020: Major Observations and Insights

For the twelve months ended December 31, 2020, the SEC issued 90 AAERs, representing a slight decrease of 3% in the number of releases between 2019 and 2020.

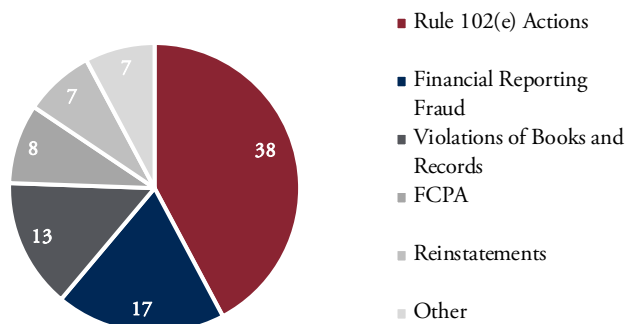
Looking Back at Total AAERs in Preceding Years



AAERs highlight enforcement actions related to auditing and accounting matters, and the SEC determines whether each enforcement release is categorized as an AAER. In 2020, AAERs comprised 13% of all enforcement actions, a slight increase of 2% when compared to 2019 results.

To evaluate the type of enforcement action behind each AAER issued in 2020, 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 of these categories in 2020.

2020 AAERs by Category



**“The Commission plays a critical role in identifying, stopping, deterring, and punishing wrongdoers. I am merely stating that we need to use our agency’s resources wisely and pick the right tool for each job, aiming in instances to improve compliance amongst our registrants—a goal which will benefit all investors.”**

Commissioner Elad L. Roisman,  
Remarks At SEC Speaks 2020,  
Washington D.C.,  
October 8, 2020

Of significance, 42% of the actions brought forth by the SEC in 2020 related to suspensions or disbarments from practicing before the SEC under Rule of Practice 102(e). These suspensions or disbarments can be temporary or permanent and levied against either an individual working at a firm or against the firm as a whole.

## The 2020 AAERs: Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues involved in the 2020 AAERs, we identified the accounting problem(s) in each based on the classification definitions below.

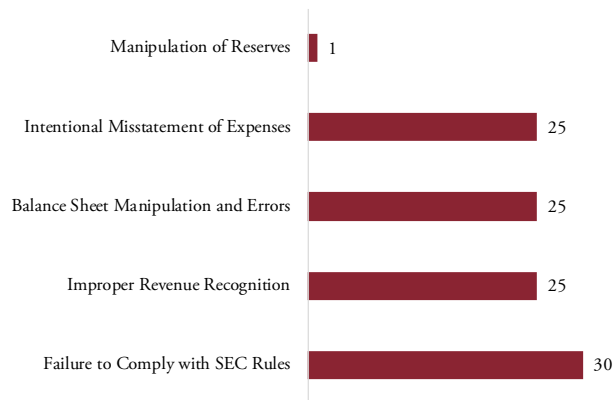
Classification	Definition
<b>Manipulation of Reserves</b>	Improperly created, maintained, or released reserves and other falsified accruals
<b>Improper Revenue Recognition</b>	Overstated, premature, and fabricated revenue transactions reported in public filings
<b>Intentional Misstatement of Expenses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

"High quality, reliable financial statements are the bedrock of our disclosure-based regulatory ecosystem, and audit quality, which is enhanced by our auditor independence framework, is a key driver of high-quality financial disclosure."

Chairman Jay Clayton, Putting Principles into Practice, the SEC from 2017-2020: Remarks to the Economic Club of New York, November 19, 2020

As shown below, failure to comply with SEC rules represents the most common financial reporting issue in the 2020 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 2020 AAERs

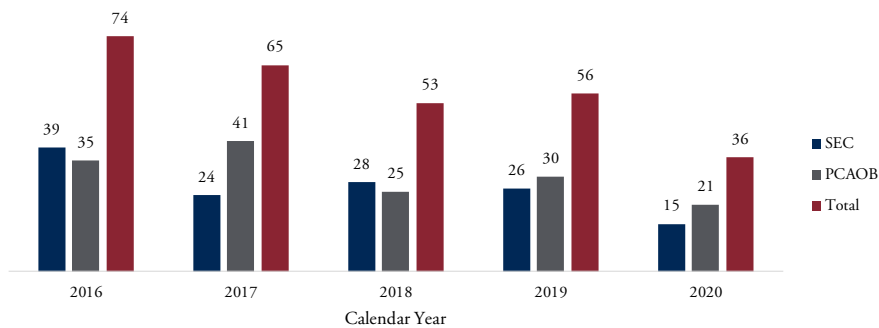


Failure to comply with SEC rules was a significant focus in 2020, as it represented 28% of all financial reporting issues identified in this year's AAERs. The majority of releases categorized as failing to comply with SEC rules relate to public filings that did not meet auditor independence requirements, a major consideration of the SEC's filing requirements. Of note, other releases included in this category include errors, omissions, and misstatements related to management's discussion and analysis, non-GAAP measures, and key performance indicators.

### *SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions*

The SEC and PCAOB share the responsibility of enforcing disciplinary actions against auditors who violate SEC rules and professional standards. In 2020, the PCAOB reported a 30% decrease in auditing-related enforcement and disciplinary actions as compared to 2019, consistent with a 42% decrease in auditing-related enforcement actions brought by the SEC during the same time frame. Most notably, between 2016 and 2020, we observe an average decrease of approximately 15% year-over-year in combined auditing-related enforcement actions brought by the SEC and PCAOB.

#### SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions



"The PCAOB plays a critical role in the financial reporting system, overseeing the audits of issuers and SEC-registered brokers and dealers to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports."

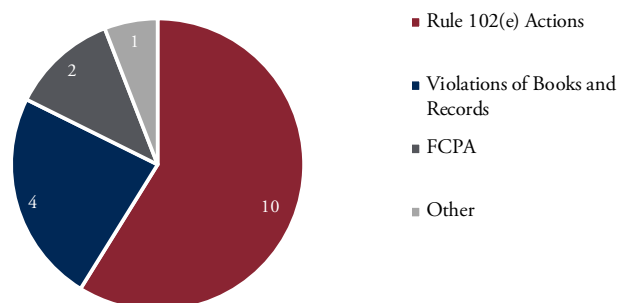
Sagar Teotia, Chief Accountant,  
Statement on OCA's Focus on High-  
Quality Financial Reporting During  
an Unusual Year and a Discussion  
of our Upcoming Priorities,  
Washington D.C.,  
December 7, 2020

## Overview of Q4 2020 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 2020. Rule 102(e) Actions led the releases in the fourth quarter, accounting for 59% of the total. Interestingly, no releases were classified as Financial Reporting Fraud or Reinstatements this quarter.

#### Q4 2020 AAERs by Category



# Notable Q4 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. 4196 / December 14, 2020, Administrative Proceeding File No. 3-20169, In the Matter of Belden Inc. and Denis Wiser, CPA, Respondents.***

## *Financial Reporting Warning Signs: Take Action or Bear the Consequences*

The United States Securities and Exchange Commission’s recent settlement with Belden Inc. (“Belden”) raises numerous lessons for legal counsel who represent public registrants, including the importance of adequately addressing internal control issues raised by acquisition due diligence procedures, assessing the pros and cons inherent in bill and hold transactions, and ensuring “know your customer” programs are in place.

The Belden settlement is reported in the SEC’s Accounting and Auditing Enforcement Release No. 4196. Below is an abbreviated background of the facts reported in the release, along with considerations and recommendations for legal counsel advising companies that may deal with similar issues.

## *Background*

Belden, a manufacturer of networking, connectivity, and cable products, headquartered in St. Louis, Missouri, improperly accelerated revenue for the first three quarters of 2017. The reporting errors occurred at its subsidiary, Grass Valley, a manufacturer of technologies for the broadcast industry, headquartered in Montreal, Canada. Belden purchased Grass Valley in 2014, and its financial results were reported as part of Belden’s broadcast segment in Belden’s consolidated financial statements.

Per the SEC, Belden first learned there were internal control problems at Grass Valley as part of the due diligence process for the acquisition in 2014. According to the release, Belden’s diligence report stated that Grass Valley’s

- “[m]anagement does not appear to be able to effectively control or monitor any channel stuffing or sales acceleration by the sales organization,” and
- “controls are likely not adequate for Belden’s SOX reporting requirements.”

Despite these warnings, the control weaknesses were not adequately addressed after the acquisition of Grass Valley. According to the SEC, Belden discovered that in 2015 Grass Valley improperly accelerated the recognition of revenue, albeit not a material amount to the overall Belden financial statements, for the shipment of goods to warehouses controlled by Grass Valley. The revenue involved a sales practice referred to as “bill and hold” transactions, which, as explained below, can be a form of accelerating sales and revenue recognition – the same concern and problem raised in the Grass Valley acquisition due diligence report.

“Companies should disclose the information that investors and the markets will find useful and important, regardless of whether there is some technical argument that compliance with specific disclosure requirements can be met with less illuminating disclosure.”

William Hinman, Director, Division  
of Corporation Finance, The  
Regulation of Corporation Finance  
– A Principles-Based Approach,  
November 18, 2020

These revenue recognition control issues continued to be a problem at Grass Valley. A member of Belden's external audit firm sent a copy of the bill and hold revenue recognition requirements to the company in early 2017. The email from the auditor stated that he had "never seen [the bill and hold requirements] met," presumably a reference to issues arising as part of the 2016 audit. Belden's Chief Accounting Officer then distributed this accounting guidance to individuals with responsibility for Grass Valley's financial reporting. The guidance stated, among other things, the very basic rules to follow including:

- the buyer, not the seller, must request that the transaction be on a bill-and-hold basis, and
- there must be a fixed schedule for delivery of the goods.

Yet, based on the release, Grass Valley continued to disregard the guidance, and improperly recorded revenue from bill and hold transactions throughout the first three quarters of 2017.

As a general statement, aggressive use of bill and hold practices, invoicing and recognizing revenue without shipping the product, arise out of pressures to create sales. In fact, the use of bill and hold transactions coupled with revenue pressures is always a high-risk situation. Further evidence of Grass Valley's revenue pressures is reported in the release when detailing the creation of a sham customer to purchase goods. The new customer scheme illustrates the extreme measures taken by Grass Valley to fabricate revenues.

According to the release, during 2017, Grass Valley conspired with a former employee to establish a new customer that would act as a distributor to lease or resell the goods. However, the former employee had no experience as a distributor, no warehouse, no customers, and no ability to pay for the goods purchased, unless and until they were sold. In fact, per the release, the new customer never re-sold or leased any goods, and the products were eventually returned to Belden. Notably, the arrangement with this alleged customer included around \$3 million of software, a transaction that should have received increased scrutiny, as the resale of software through a distributor raises additional revenue recognition concerns. In short, the new customer was a complete sham.

In total, more than 140 transactions, totaling over \$62 million in sales, were prematurely recorded in Belden's books and records through the end of 2017. As a result, Belden's reported revenue was overstated by more than \$29 million for the first three quarters of 2017. Most of the revenue recorded in connection with these transactions was ultimately reversed in the fourth quarter of 2017.

### *Lessons and Actions to Avoid Similar Problems*

The following recommendations highlight possible actions that could have been taken by Belden management and/or the company's audit committee, both with the assistance of legal counsel, to avoid the problems described above.

**"I have seen cases regarding registrants where inadequate controls or oversight in place enabled violations of our rules."**

Commissioner Elad L. Roisman,  
Remarks At SEC Speaks 2020,  
Washington D.C.,  
October 8, 2020



## Heed Due Diligence Report Warnings

Companies frequently engage specialized teams, generally made of experienced CPAs and others, to inspect the books and records of potential target companies. Quite often the diligence team prepares estimates for projected potential cash flows upon which valuation models are prepared. The diligence team also generally provides commentary on qualitative aspects of the target's accounting policies, systems, and controls. Of significance, the first warnings for Belden regarding Grass Valley's weak internal controls and management's inability to enforce the limited controls in place appeared in 2014, in the acquisition's due diligence report.

The release mentions that Belden took some corrective actions based on the diligence report findings but needless to say, these actions did not sufficiently mitigate the issues that were identified in 2015 and continued into 2017. The extent of Belden's corrective actions is not reported, however steps that should have been considered and taken when dealing with the types of internal control weakness described in the diligence report include:

- Involving the audit committee to ensure the control problem is addressed at the board level;
- Immediately implementing Belden's internal control policies at Grass Valley;
- Evaluating the Grass Valley financial reporting personnel to ensure adequate and competent people are in place, and, if required, bringing in new leadership;
- Scheduling and designing special internal audit testing for the new subsidiary;
- Evaluating the risk raised during due diligence related to the lack of monitoring any "channel stuffing or sales acceleration by the sales organization," and immediately replacing sales leadership personnel if required;
- Designing training for finance, accounting, and sales personnel on Belden policies;
- Creating and distributing a hotline for employee communications regarding ethics concerns;
- Requesting additional external auditor testing, even as a special agreed upon procedures engagement.

Had Belden taken these types of actions to address the serious concerns identified in 2014, it likely would have avoided the subsequent problems and having to disclose in the company's 2017 Form 10K that it "did not maintain internal controls that were sufficiently designed and operating effectively to ensure that all revenue recognition criteria were satisfied prior to the recognition of revenue" in its Grass Valley unit.

## Assess the Pros and Cons of Bill and Hold Transactions

To invoice a customer and record revenue, but not deliver the goods, is unusual. Delivery is one of the key revenue recognition criteria. Bill and hold transactions are an exception to the general delivery rule, are inherently risky, and require strict adherence to bright line tests to support the existence and timing for recording a sale.

Given this, before agreeing to allow bill and hold transactions at a new subsidiary, Belden would have been well advised to assess the business reasons, benefits, and special risks associated with allowing such a policy to continue.

**"The importance of good disclosure to the broader markets and the public cannot be overstated.**

**Disclosure that is specific and tailored to a company's circumstances, that is well-vetted by accounting, legal and financial gatekeepers, provides everyone with information that can be trusted and acted on with confidence."**

William Hinman, Director, Division of Corporation Finance, The Regulation of Corporation Finance – A Principles-Based Approach, November 18, 2020

At a minimum, until a company is comfortable with its controls, it should strongly consider suspending such transactions. The “cost” to suspend bill and hold transactions is minimal in comparison to the problems arising from errors and misconduct. In fact, the “cost” of suspending or even eliminating bill and hold transactions is limited to deferring revenue recognition into a subsequent period, not a permanent loss of the sale. Plus, financial statement disclosures are a very meaningful way to inform and manage investor reactions as to the impact of changing from such a policy to normal delivery terms for revenue recognition.

## Know Your Customers

As a general statement, businesses seek to generate new customers. Customers buy products and services and deliver cash and profits to businesses. From an accounting and revenue recognition standpoint though, new customers need to be thoroughly vetted as to whether they can pay their invoices and to ensure they are credible businesses.

When you add these sensitivities to the risks inherent in any bill and hold transaction, knowing who the customer is becomes an even more critical element of strong revenue recognition internal controls. However, as described in the release, Belden’s internal control system failed to properly evaluate and vet its new customer.

Had Belden performed a background check, requested financial statements for credit worthiness, or performed basic diligence on the new customer before recording revenue and extending credit to the business, it would have quickly uncovered the entity was a sham created for the purpose of recording sales.

In closing, the due diligence report and team had it right when they concluded that Grass Valley management was not “... able to effectively control or monitor any channel stuffing or sales acceleration by the sales organization” and the Grass Valley controls were “...likely not adequate for Belden’s SOX reporting requirements.” Had the warning signs been taken more seriously and immediate remedies been implemented, we may not have had the lessons learned from this release to share.

**“So, how do you overcome obstacles? The expected and unexpected? For me, it required two things: (1) an organization that is expert in its subject area—in our case knowing investors, disclosure principles, capital formation and market function—and (2) working proactively, with a focus on outcomes. In common words, ‘doing the right thing.’”**

Chairman Jay Clayton, Putting Principles into Practice, the SEC from 2017-2020: Remarks to the Economic Club of New York, November 19, 2020

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#### **ABOUT Floyd Advisory**

Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of SEC reporting, transaction advisory, investigations and compliance, litigation services, as well as business strategy and valuation.

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