



*Summary of Accounting and
Auditing Enforcement Releases
for the Quarter Ended
June 30, 2022*

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

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Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission, Division of Enforcement’s Accounting and Auditing Enforcement Releases (“AAERs”) for the quarter ended June 30, 2022.

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

The Division of Enforcement at the U.S. Securities and Exchange Commission (“SEC” or “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 useful interpretations and applications of the securities laws.

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

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

Floyd Advisory
JULY 2022

Highlights:

- The SEC released twenty-one AAERs in Q2 2022, with Rule 102(e) sanctions leading all other types of reported violations. Five Rule 102(e) sanctions also had proceedings instituted against respondents pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934. Similar to Rule 102(e), Section 4C specifies that the SEC may censure or deny any person the privilege of appearing or practicing before the Commission. Section 21C relates to cease-and-desist proceedings for violations of securities laws.
- The SEC imposed the largest civil penalty on an audit firm in the amount of \$100 million as a result of cheating by audit professionals on the ethics portion of their certified public accountant (“CPA”) exam and continuing professional education (“CPE”) courses required to maintain their CPA licensure. In addition, the firm allegedly misrepresented to the SEC staff, who were investigating the potential cheating at the firm, that there was no misconduct.
- The SEC imposed a civil penalty in the amount of \$12.5 million on a technology company for improper revenue recognition. Six additional releases involved individuals who held various senior leadership roles at the company. Civil penalties imposed on leadership at the company totaled \$220,000 plus \$1,312,326 in restitution.
- In our “Recommended Reading” section, we discuss a case involving a financial reporting fraud matter related to improper earnings management practices. We summarize the release and offer key considerations for management and their advisors when assessing quarter end results.
- The PCAOB conducted interviews of more than 240 public registrants’ audit committee chairs regarding numerous topics related to their oversight of independent auditors and other qualitative factors concerning the audit function. In our “Special Feature” section, we discuss the subjects and major observations which arose from these discussions and are summarized in the PCAOB report.

“It is of paramount importance that public accounting firms foster a culture of ethical behavior with respect to all aspects of their professional responsibilities.”

Paul Munter,
Acting Chief Accountant
June 8, 2022
The Critical Importance of the
General Standard of Auditor
Independence and an Ethical
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OUR PROCESS AND METHODOLOGY

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

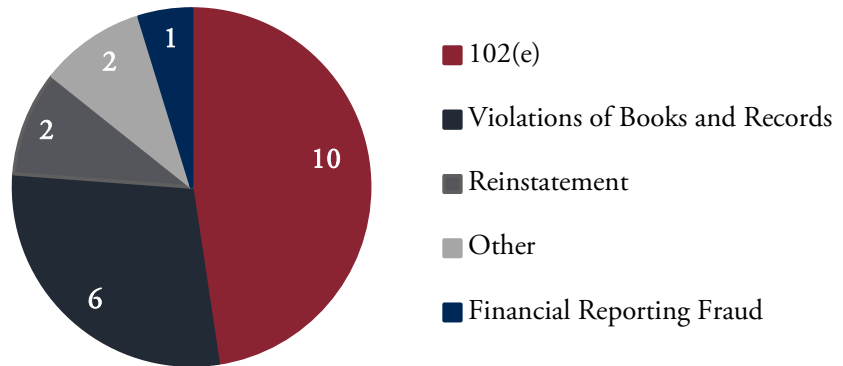
To meet our objective of summarizing the major items reported in the AAERs, we reviewed those releases identified and disclosed by the SEC on its website, www.sec.gov.

As part of our review, we gathered information and key facts, identified common attributes, and noted trends. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (i.e., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations (“FCPA”), Reinstatements to Appear and Practice before the SEC, Violations of Books and Records, and Other). Do note, when a release included more than one allegation, admission, or violation, we categorized the release by the most significant issue. Based on this process and methodology, we prepared a database of the key facts contained in each release.

The Q2 2022 AAERs: Summary by Category and Insights from the Releases

The SEC released twenty-one AAERs during Q2 2022, with Rule 102(e) actions representing nearly half of all releases this quarter.

Q2 2022 AAERs by Category



"As we've seen in a number of recent cases, when clients take steps to self-report potential violations, or to proactively cooperate with our investigations and remediate violations, the Commission is often willing to credit that cooperation, including through reduced penalties, or even no penalties at all."

Gurbir S. Grewal,
Director, Division of Enforcement
May 12, 2022
Remarks at Securities Enforcement
Forum West 2022

While our categorical breakdown is analytically useful, a closer look at specific cases for each category provides a better understanding of the SEC's areas of focus as an enforcement agency.

Rule 102(e) Actions

Ten AAERs related to Rule 102(e) actions were released during this quarter. Rule 102(e) actions involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC. Examples of this quarter's Rule 102(e) releases include the following:

- The SEC suspended a CPA as a result of their felony conviction.*** The CPA, an owner of an accounting firm and Treasurer and CFO of another company, was convicted of six counts of wire fraud and four counts of money laundering in the U.S. District Court of Missouri. The case alleges that from February 2014 to October 2016, the CPA engaged in a scheme to defraud the company of which he was Treasurer and CFO as well as several clients of the CPA firm. As noted in the release, the CPA transferred at least \$4.4 million from the company into their personal and business accounts. The case further alleges the CPA misrepresented how loans and investments would be used in order to persuade clients to give him money. According to the case, the CPA used this money for personal expenses and to pay back other clients' investments. The CPA was sentenced to 188 months of imprisonment followed by three years of supervised release and was ordered to pay restitution in the amount of \$8,832,828 and forfeit a \$696,000 interest in a home. As a result of the felony conviction, the SEC suspended the CPA from appearing or practicing before the Commission.

- ***The Commission censured a public accounting firm under Rule 102(e) and Sections 4C and 21C of the Securities Exchange Act of 1934.*** According to the release, the firm failed to conduct quarterly reviews and an annual audit for 2017 in accordance with Public Company Accounting Oversight Board (“PCAOB”) guidelines. The release further alleges that improper professional conduct by the company included deficiencies in quality control reviews, lack of professional skepticism, lack of review of evidence in support of clients' conclusions, and failure to perform audit procedures appropriate to the identified risk. As noted in the release, the company was ordered to be under the review of an Independent Consultant Reviewer who will review and evaluate the company's audit, review, and quality control policies and procedures. Further, the company was prohibited from accepting new clients under certain criteria. The company was also ordered to pay a civil money penalty in the amount of \$1.9 million.
- ***The Commission suspended a CPA for insider trading under Rule 102(e) and Sections 4C and 21C of the Securities Exchange Act of 1934.*** In the release, the CPA admitted they purchased stock based on material nonpublic information they obtained related to two of their publicly traded clients while working at a tax services firm. The CPA purchased the stock of their client in advance of its quarterly and year-end earnings announcement. Further, in March 2018, the CPA purchased the stock of another client prior to the announcement of a merger. As a result of the insider trading, the CPA obtained illicit profits of approximately \$48,000. The CPA was denied the privilege of appearing or practicing before the Commission as an accountant and was ordered to pay disgorgement of \$47,850, prejudgment interest of \$9,507, and a civil money penalty of \$47,850.
- ***The Commission censured an audit firm under Rule 102(e) and Sections 4C and 21C of the Securities Exchange Act of 1934.*** Per the release, the audit firm failed to act with the integrity required of a public company auditor. Additionally, from 2017 to 2021, several of the firm's audit professionals cheated on the ethics component of the CPA exam as well as on a variety of other CPE courses that are required to maintain their CPA license. According to the release, a significant number of professionals, who did not cheat themselves, knew their colleagues were cheating and facilitating cheating, which violated the firm's Code of Conduct for failure to report the misconduct. The SEC's Division of Enforcement sent a formal request for information about complaints the firm received regarding cheating, and despite having issues with cheating and performing an internal investigation, the firm's submission to the request stated it did not have any current issues with cheating. The audit professionals' repeated cheating on exams and the firm's alleged misrepresentations to the SEC violated ethics and integrity standards and discredited the accounting profession. The firm admitted to the findings in the release and submitted an offer of settlement, which the Commission accepted. The firm was censured and ordered to pay a \$100 million civil penalty.

“Today’s settlement, however, also quietly sets the precedent that failing to correct a response to a voluntary information request received from the Securities and Exchange Commission (‘SEC’ or ‘Commission’) might be a strict liability offense punishable with outsized penalties and other costly remedial measures.”

Hester M. Peirce,
Commissioner of the SEC
June 28, 2022
When Voluntary Means Mandatory
and Forever: Statement on In the
Matter of Ernst & Young LLP

Violations of Books and Records

This quarter we categorized six AAERs under Violations of Books and Records, a category that includes alleged improper accounting treatments and internal control problems deemed worthy of an enforcement action but not meriting financial reporting fraud allegations. Below is a summary of two releases within this category:

- The SEC imposed a cease-and-desist order against a technology company.*** According to the release, in July 2018, the audit committee of a technology company concluded the previously issued financial statements for the fiscal years (“FY”) ended December 31, 2014, 2015, and 2016 and their respective quarterly periods should not be relied on. As a result, the company announced a restatement of its audited financial statements for FY 2015 and 2016 and restated selected financial data for FY 2013 and 2014 totaling approximately \$190 million in cumulative revenues. According to the release, the company acknowledged that it had accounted for numerous transactions improperly during the restated period and had recognized revenue improperly and in a manner inconsistent with GAAP. In its restatement, the company also acknowledged weaknesses in its internal control over financial reporting (“ICFR”) for the restatement period. As a result, the company filed materially misstated financial statements during 2013 through 2016. The company was ordered to pay a civil money penalty in the amount of \$12,500,000.
- The Commission imposed a cease-and-desist order against a CEO.*** As stated above, during fiscal years 2013 through 2016, the aforementioned technology company improperly recognized revenue. During this time, the CEO received bonuses, incentive-based compensation, equity-based compensation, and realized profits from their sales of the company’s stock. The release alleges that the CEO has not reimbursed the company for those profits but has returned all of the options granted during the claw back period. The CEO admitted to the findings in the release and submitted a settlement offer, which was accepted by the Commission. The CEO was ordered to reimburse the company for a total of \$1,312,326 and return 16,266 shares received as their incentive compensation, or the cash equivalent value calculated based on the closing price of January 24, 2022.

“We must always remain vigilant to opportunities to enhance transparency, which helps foster innovation and growth, and helps maintain our markets as the world’s gold standard.”

Gary Gensler,
Chairman of the SEC
May 6, 2022
A Century with a Gold Standard

Reinstatements

There were two releases in Q2 2022 related to the reinstatement of CPAs to practice before the SEC. The following is a summary of a release within this category:

- The Commission reinstated a CPA as an independent accountant.*** In the original release, the Commission found that the CPA improperly served as the lead engagement partner on the first and second quarter 2013 reviews of a client after having served as the lead engagement partner for the preceding five years. In addition, the CPA failed to comply with professional standards with respect to the review of disclosures surrounding two significant transactions. The CPA has shown good cause for reinstatement. As a result, they have been reinstated with the requirement that their work be reviewed by the independent audit committee of any company for which they work.

Financial Reporting Fraud

There was one release in Q2 2022 related to Financial Reporting Fraud. This release is discussed in further detail within our “Recommended Reading” section.

Notable Q2 2022 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 and colleagues. For this quarter, we selected the following AAER to highlight.

Accounting and Auditing Enforcement Release No. 4294 / April 18, 2022, In the Matter of Rollins, Inc., and Paul Edward Northen.

The SEC recently settled a financial reporting fraud matter involving improper earnings management practices by Rollins, Inc. (“Rollins”), a public registrant. The case involved unsupported adjustments to accounting reserves for the alleged purpose of meeting analyst earnings per share (“EPS”) expectations for the quarters ended March 31 and June 30, 2017. Of significance, per the SEC, the improper adjustments resulted in less than a penny changes to EPS, such that the originally produced EPS amounts could be rounded up to the next penny for external reporting purposes.

Financial reporting involves numerous judgments, estimates, and assumptions. However, every judgment, estimate, and assumption should be based on professional assessments of all available facts as well as the application of Generally Accepted Accounting Principles (“GAAP”). The final cumulative net income result for the registrant should never be part of the equation.

As important, a company’s ICFR should require that such estimated amounts be well documented, delegated to the appropriate level personnel, and reviewed and approved by senior members of the accounting and finance team. Audit committees and their legal counsel that work with them play a special role in the oversight of the financial reporting for a public registrant and can benefit from reading the SEC’s AAERs regarding Rollins and asking management and their auditors a couple of simple questions at quarter end, including but not limited to:

- Are all accounting estimates supported by contemporaneous documentation?
- Were any adjustments made by senior management during the closing process to amounts previously assessed by those with the delegated responsibility to make such assessments?
- Have the auditors tested for similar activity, and are they comfortable with all adjustments made during the financial reporting close process?

“The public needs to know when they read a news story about corporate malfeasance that we will move quickly to investigate what happened and hold wrongdoers accountable, even in the most complex cases.”

Gurbir S. Grewal,
Director, Division of Enforcement
May 12, 2022
Remarks at Securities Enforcement
Forum West 2022

Before dismissing the situation as not likely at your company, consider that the audit committee at Rollins likely felt the same way. Do note, the consequences for Rollins included an \$8 million civil penalty imposed by the SEC, as well as disruption and other significant costs to the business, and all for less than a penny! Additionally, Paul Edward Northen, the former CFO, Senior Vice President, and Treasurer of Rollins, paid a civil penalty of \$100,000 for his role in directing the reductions to accounting reserves.

Special Feature: PCAOB “Conversations with Audit Committee Chairs”

“We believe that auditor independence is grounded in an understanding of accounting as a profession rather than an industry, which is critical to serving the public interest. As a profession, accountants have a responsibility to the public interest and to act ethically and with integrity in every professional activity.”

Paul Munter,
Acting Chief Accountant
June 8, 2022
The Critical Importance of the
General Standard of Auditor
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As part of its most recent audit firm inspection process, the PCAOB conducted interviews of more than 240 public registrants’ audit committee chairs and issued a summary of the comments and observations from the discussions.¹

Audit committees play a critical role in the financial reporting system, including having responsibility for the oversight of the registrant’s auditor and the audit process. Summarizing the feedback from over 240 audit committee chairs provides insightful information regarding the state of the audit profession and the overall financial reporting process. The information is useful for auditors, boards, audit committees, as well as the attorneys and advisors who serve them.

For context, the PCAOB is an independent entity created by the Sarbanes-Oxley Act to oversee the audits of public registrants. The PCAOB’s objective is to “protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.”

As part of fulfilling its mission, the PCAOB inspects the quality of the work performed by registered public accounting firms to ensure compliance with professional standards and securities laws. Of significance, the PCAOB produces a report for each firm that describes deficiencies identified during the inspections. These reports are available to the public and accessible on the PCAOB website.

As mentioned above, the PCAOB invites the audit committee chairs from the U.S. public registrants whose audits are selected for inspection to speak with the PCAOB’s staff regarding numerous topics related to their oversight of the independent auditors and other qualitative factors regarding the audit function.

The subjects and major observations from these discussions are summarized in the PCAOB report, and include:

¹ See full PCAOB report at https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/documents/2021-conversations-with-audit-committee-chairs-spotlight.pdf?sfvrsn=a9ffc7_7

Required Communications between Auditor and Audit Committee

During 2021, the most frequent matters discussed by auditors with the audit committees related to the accounting for goodwill and related impairments, revenue recognition, and recording credit losses. Other subjects discussed included critical audit matters, the overall audit process, controls, cybersecurity risks, the impact of COVID-19, independence and other risk issues, including fraud.

Discussions other than Required Communications

Audit committees discussed management “tone at the top” and competence, general industry matters, big-picture business trends, and the regulatory state of play in financial reporting and standard setting. Interestingly, numerous audit committee chairs described using the auditor as a “sounding board” to enhance their “understanding of management.”

Auditor Strengths and Areas for Improvement

Many audit committee chairs expressed appreciation for their auditor’s comprehensive, timely, and focused communications, as well as in-depth industry knowledge. Audit committee chairs also stated they valued a proactive and responsive audit approach, as well as “candor and transparency” in their auditor discussions, free from a “promotional or selling tone.”

Those offering critiques of their auditors raised some of the opposite viewpoints including instances of poor communication, work left to the last minute, cost concerns, and turnover on the audit team.

Review and Discussion of PCAOB Inspection Reports

Per the PCAOB, of those audit committee chairs who answered if they reviewed their audit firm’s PCAOB inspection report definitively (i.e., yes or no), roughly 70% either review the PCAOB’s inspection report independently or at least discuss the results of the report with their auditor. Audit committee chairs generally viewed the PCAOB inspection reports favorably, including many using their auditor firm’s peers’ reports for a qualitative comparison. Some chairs expressed concerns with the timeliness of the PCAOB reports and a desire for more detailed disclosures in the reports.

“Any perceived erosion of auditor independence or the profession’s ethics or integrity breaks down the critical gatekeeper role of public accountants and can, over time, lead to diminished investor confidence.”

Paul Munter,
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Quality Control Systems at Audit Firms

Audit committee chairs expressed satisfaction with their auditor's overall quality control, specifically recognizing their auditor's standardized processes, focus on continuing education for staff and their audit firm's "layers" of review, including the use of specialists as needed.

Several audit committee chairs favorably recognized their auditor's proactive emphasis on "tone at the top" and corporate governance during the audit process.

Annual Assessments of the External Auditor

Per the report, of the audit committee chairs who responded to whether they made an annual assessment, 75% said they did an annual formal assessment of the auditor, with the remaining committees not doing an assessment or doing something informal.

Importantly, the report describes some of the steps performed by those undertaking formal annual assessments, providing a list of possible "best practice" considerations for others.

Auditor's Use of Technology

Many audit committee chairs continued to see "transformative potential in the use of technology," although some also highlighted challenges. As described by one committee chair, technology should be considered as "supplemental tools." Another expressed concern that technology had the potential to lessen the auditor's "ability and inclination to incorporate their business insights into procedures."

Information Outside the Financial Statements

Per the PCAOB, of the audit committee chairs who responded to discussing matters other than their financial statements with their auditors, approximately 70% cited environmental, social, and governance (ESG) matters as a key area of discussion.

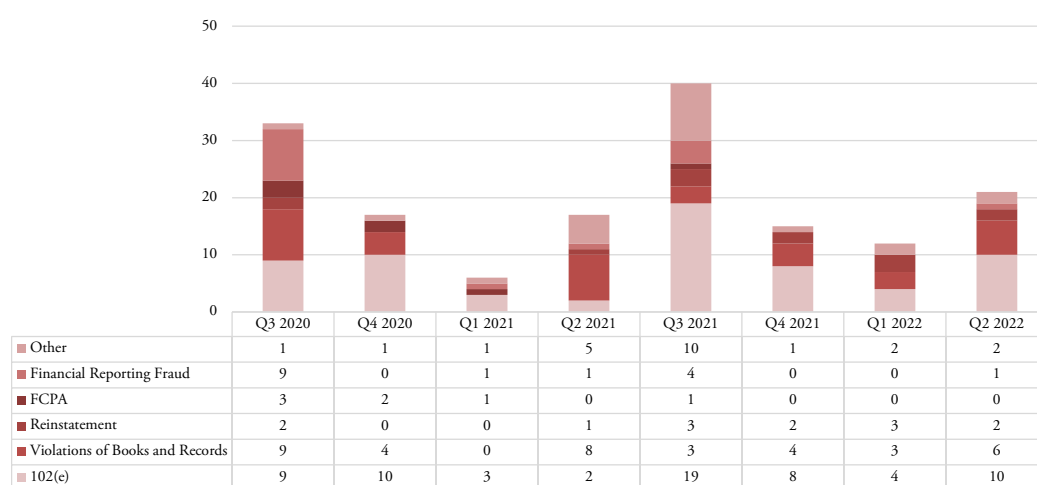
The audit committee chairs who cited ESG, described it as a "huge issue," "hot topic," and as "pressure from investors." ESG discussions with auditors involved reporting accurate data, new information gathering processes, and importantly, controls.

Prior Period Comparison: Quarter to Quarter

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

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

Quarter to Quarter AAER Comparison
Q3 2020 through Q2 2022



Based on this data, we made the following observations:

- Rule 102(e) sanctions continue to be the most common category of releases, on average accounting for 41% of total AAERs released each quarter over the prior two years. Of significance, the SEC has increased the number of reinstatements over the past four quarters as compared to the prior four quarters.
- The Financial Reporting Fraud category saw its first AAER categorized as such since Q3 2021. This is compared to the fifteen releases in the prior five quarters from Q3 2020 through Q3 2021.
- The number of AAERs categorized as FCPA-related declined over the last four quarters, with only one AAER as compared to six in the prior four quarters.
- The third quarter (Q3) consistently has the largest number of releases each year. It will be interesting to see if this trend continues into Q3 2022, given the SEC’s historical focus of settling enforcement actions prior to its fiscal year-end of September 30.

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ACKNOWLEDGEMENT

We wish to acknowledge the valuable contribution to this analysis by Shayna Sparrow, Michael Ho, and Joseph Floyd.

For more information, please contact LeeAnn Manning at 617.586.1076 or Marni Kaufman at 617.586.1072.

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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