



*Summary of Accounting and
Auditing Enforcement Releases
for the Year Ended
December 31, 2024*

ANNUAL REPORT 2024

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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’s (“SEC,” “Commission”) Division of Enforcement’s Accounting and Auditing Enforcement Releases (“AAERs”) for the quarter and calendar year ended December 31, 2024.

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 SEC is a law enforcement agency established to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As such, the actions it takes and the releases it issues 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
JANUARY 2025

Highlights:

- The SEC released a total of 64 AAERs in calendar year 2024, a 42% decrease from 2023 and the lowest number of calendar year releases in at least the past ten years. Conversely, during the fourth quarter, a total of 20 AAERs were released, which is notably higher than the average number of fourth-quarter releases for the prior five years (14).
- In the fourth quarter, the SEC issued \$396 million in penalties, representing approximately 60% of the \$663 million total penalties this calendar year. Notably, nearly all fourth quarter penalties related to Financial Reporting Fraud and FCPA matters.
- The fourth quarter had five FCPA-related releases, the most in any quarter since the third quarter of 2018. The five releases involved four companies and one individual.
- In our “Recommended Reading” section, we describe a Financial Reporting Fraud release related to one of the world’s largest package delivery companies and its failure to timely record a write down and impairment loss on its balance sheet for a poorly performing business unit. This section provides key background facts, relevant GAAP guidance regarding impairment testing, and the roles and responsibilities of key parties responsible for the company’s financial reporting.

OUR PROCESS AND METHODOLOGY

The AAERs issued by the SEC are defined as financial reporting-related enforcement actions concerning civil lawsuits brought in federal court and notices and orders concerning the institution and/or settlement of administrative proceedings related to an individual, an accounting firm, or a company (hereafter, “Company”). The 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 the releases identified and disclosed by the SEC on its website, www.sec.gov.

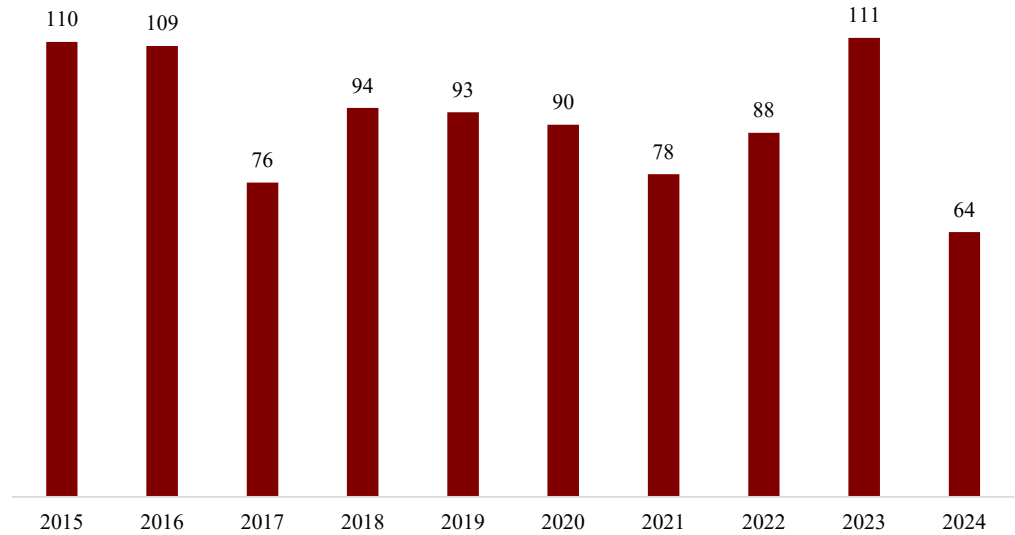
As part of our review, we gathered information and key facts, identified common attributes, and noted trends. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (i.e., Rule 102(e) Actions, Violations of Books and Records, Financial Reporting Fraud, Reinstatements to Appear and Practice before the SEC, Foreign Corrupt Practices Act (“FCPA”) Violations, and Other¹). When a release included more than one allegation, admission, or violation, we categorized the release based on the most significant issue. Based on this process and methodology, we prepared a database of the key facts contained in each release.

¹ AAERs categorized as “Other” are generally related to certain logistical aspects of SEC proceedings, such as orders regarding scheduling, decision extensions, status reports, and alternative methods of communication.

Major Observations and Insights: AAERs for the Twelve Months Ended December 31, 2024

For the twelve months ended December 31, 2024, the SEC issued 64 AAERs, representing a 42% decrease from calendar year 2023 and the lowest number of calendar year releases in at least the past ten years.

Looking Back at Total AAERs in Preceding 10 Years



“Everything we’ve done is focused on ensuring compliance with our laws. What we’ve found since the 1930s is that compliance matters. It protects investors. It builds trust in our capital markets. It helps issuers tap into our markets. History has shown for 90 years that robust securities regulation both creates trust in markets and fosters innovation.”

Gary Gensler

SEC Chair

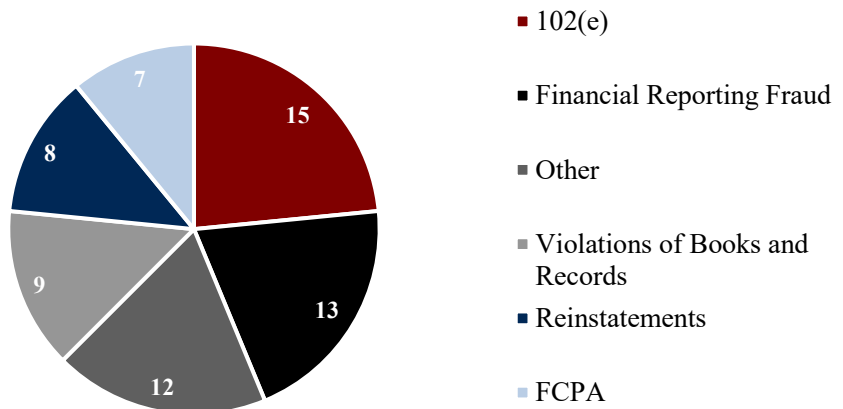
November 14, 2024

Car Keys, Football, and Effective Administration

Of significance, 23% of the actions brought forth by the SEC in calendar year 2024 related to Rule 102(e) Actions. This continues a significant downward trend observed within the past three calendar years, as Rule 102(e) Actions made up 43% of all releases in calendar year 2022 and only 32% in calendar year 2023. These actions relate to temporary or permanent suspensions or disbarments of professionals from practicing before the SEC. In addition, as it relates to an entity, the SEC can also order censures or limitations of certain activities under Rule 102(e).

The following chart illustrates the 64 AAERs in calendar year 2024, by category:

Total 2024 AAERs by Category



Notably, the SEC issued approximately \$663 million in total penalties this calendar year, of which 60% were related to releases issued in the fourth quarter. Financial Reporting Fraud and FCPA-related releases alone resulted in approximately \$395 million in fourth quarter penalties.

The breakdown of total penalties by both quarter and release category for all of calendar year 2024 are reflected in the tables below:

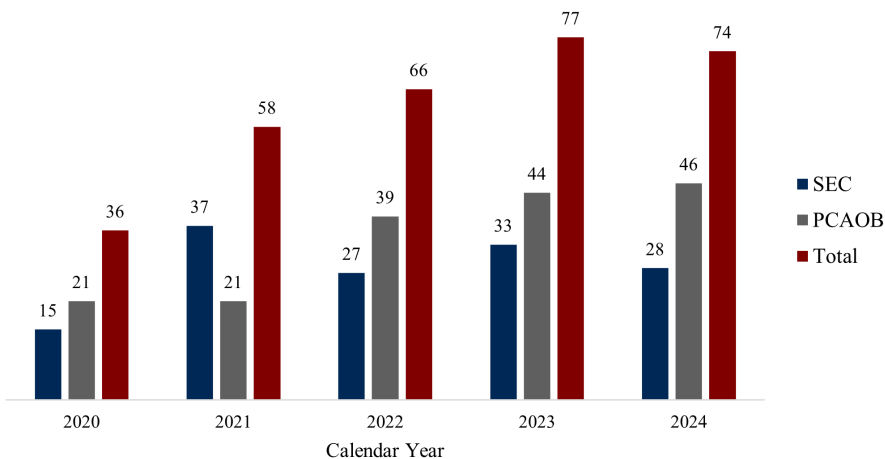
Quarter	Total Penalties	% of Total
Q1	\$124,509,637	19%
Q2	20,219,839	3%
Q3	122,419,964	18%
Q4	396,273,452	60%
Total	\$663,422,892	100%

Release Category	Total Penalties	% of Total
Financial Reporting Fraud	\$351,484,299	53%
FCPA	267,672,873	40%
Violations of Books and 102(e)	26,555,000	4%
Reinstatements	-	0%
Total	\$663,422,892	100%

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 calendar year 2024, the number of auditing-related enforcement actions brought by the PCAOB continued a slight upward trend, in contrast to the SEC as noted in the graph below. The total combined number of auditing-related enforcement actions issued by the SEC and PCAOB decreased by 5% from calendar year 2023. This slight decrease disrupts the general upward trend observed year-over-year since 2020.

SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions



“In fiscal year 2024, the Commission brought recordkeeping cases resulting in over \$600 million in civil penalties against more than 70 firms, including the Commission’s first cases charging recordkeeping violations against municipal advisors. Since December 2021, that initiative has resulted in charges against more than 100 firms and over \$2 billion in penalties. The firms all admitted that their conduct violated the recordkeeping requirements.”

Sanjay Wadhwa

Acting Director, SEC Division of Enforcement

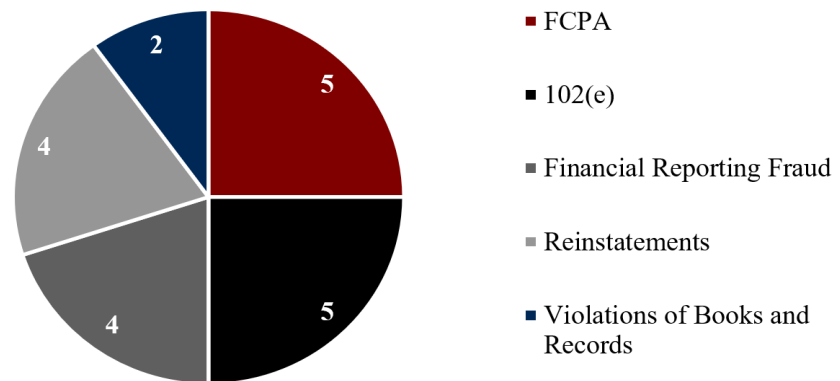
November 6, 2024

Remarks at Securities Enforcement Forum D.C. 2024

The Q4 2024 AAERs: Summary by Category and Insights from the Releases

The SEC released 20 AAERs during the fourth quarter of 2024. FCPA-related releases and 102(e) Actions were tied for the most prevalent category, followed closely by Financial Reporting Fraud and Reinstatements. The following graph further illustrates fourth quarter AAERs by category:

Q4 2024 AAERs by Category



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

Financial Reporting Fraud

Four AAERs were categorized as Financial Reporting Fraud this quarter, resulting in more than \$235 million in penalties. Three of these releases are summarized below and the fourth is summarized at the end of this report in our Recommended Reading section:

- The SEC charged the former Principal Executive Officer (the “former Executive”) of a telecommunications company for signing non-GAAP compliant financial statements that fraudulently overstated revenue.*** The release alleges that from 2018 through mid-2019, the company improperly recognized revenue by approximately \$12 million in 2018 and \$30 million in the first two quarters of 2019. According to the release, the company recorded revenue during this period for non-binding purchase orders as well as for orders that had not yet been shipped. Additionally, the former Executive failed to recognize or act upon several warning signs that indicated the company’s revenue was overstated. As early as mid-2018, the former Executive became aware of the accounts receivable balance increasing rapidly and the company’s difficulties in collecting that balance over time. By early 2019, the company created a team solely focused on collections efforts, but it failed to reduce the increasing accounts receivable balance by any significant amount. By the close of the second quarter in 2019, the outstanding accounts receivable balance had grown to \$45 million. The release states that the former Executive received a performance-based bonus of approximately \$267,000 in the 12 months following the misstated financial statements. Due to his alleged role in the misconduct, the Commission ordered the former Executive to pay a civil money penalty of \$75,000 and return the approximately \$267,000 improper bonus payment that he received.

“The work of the SEC is vital to the health of our capital markets, to the investing public, and to the future of our country.”

Jaime Lizárraga

SEC Commissioner

November 22, 2024

Commissioner Lizárraga Statement on His Planned Departure from the Commission

- The Commission imposed a cease-and-desist order against an animal health products manufacturer for failing to disclose certain key sales practices and misleading investors.*** According to the release, the company offered incentives such as discounts, rebates, and extended payment terms to distributors to ensure they made a certain number of purchases before quarter-end. This practice resulted in the company meeting short-term internal revenue targets but posed a risk of negative revenue impacts in later quarters due to excess inventory held by the distributors. The release states that the company relied on this practice through its IPO in September 2018 and until March 2020, misleading its investors in public filings, earnings calls, and other public releases and calls related to the post-IPO period, citing increased consumer demand as the reason for its strong revenue performance instead of disclosing the significant portion of incentivized quarter-end sales. In March 2020, amid growing concerns among senior leadership about risks to future revenue and the onset of the COVID-19 pandemic, the company ended its use of incentives and began focusing on reducing its distribution channel inventory. As a result, it experienced a significant decrease in revenue. In its communications to investors, instead of explaining its shift from past practices, it attributed the decrease in revenue to a “strategic change.” As a result, the SEC ordered the company to pay a \$15 million civil money penalty.
- The SEC charged a global medical technology company for repeatedly misleading investors about the risks and income connected to one of its most profitable products.*** The release alleges that in 2016, the company became aware that a key product, accounting for nearly 10% of the company’s profits, required new regulatory clearance from the FDA due to changes to the medical device. The company failed to obtain the specified clearance but continued to sell the device without disclosing the issue to investors or patients. The release states that by 2019, the company was aware that the device posed significant safety risks to patients and would likely require a product recall. The company suspended sales temporarily but ultimately resumed shipments after developing an interim software to fix the “issues presenting risks of the greatest potential harm.” The FDA neither approved this remediation process nor cleared the medical device for release back into the market. Additionally, the company failed to record the associated remediation costs required to fix the device on its books, resulting in a 5% overstatement of its income before taxes in fiscal year 2019. Furthermore, the company misled investors regarding the nature of software changes it implemented and the regulatory standing of the medical device with the FDA until February 2020, when it finally announced all sales of the product would cease until it obtained official clearance from the FDA. This announcement resulted in a 12% decrease in the company’s share price. As a result of the company’s alleged misconduct, the SEC ordered it to pay a civil money penalty of \$175 million and engage in undertakings such as retaining an independent compliance consultant to evaluate and make recommendations related to the company’s procedures for product remediation and disclosure controls.

Violations of Books and Records

This quarter, we categorized two AAERs as Violations of Books and Records, a category that includes alleged improper accounting treatments and internal control issues deemed worthy of an enforcement action, but not warranting categorization as Financial Reporting Fraud. The two releases for this quarter are summarized below:

- The Commission imposed a cease-and-desist order against a fashion retailer for failing to disclose certain perks and personal benefits paid to its Chief Executive Officer.*** The SEC alleges that, in the definitive proxy statements for fiscal years 2019 through 2021, the company failed to disclose nearly \$1 million in perks and personal benefits paid to its CEO. These payments were primarily related to the CEO’s usage of a chartered private aircraft and other personal travel costs that the company recorded as normal business expenses. After realizing the perks paid to the CEO were inaccurately recorded in its proxy statements, the company engaged outside counsel to perform an internal investigation and self-reported the issue to

“Well-functioning financial markets are built on trust. Critical to such trust are disclosures – including financial statement disclosures made by issuers and broker-dealers to the investing public.”

Gary Gensler

SEC Chair

December 18, 2024

Statement on PCAOB 2025 Budget

the SEC. The company also made the correct disclosures in its 2022 proxy statement and provided revised disclosures for 2020 and 2021, while the CEO reimbursed the company approximately \$450,000 for the perks and personal expenses the company previously paid. The SEC considered the company's cooperation and remedial measures and did not impose a civil money penalty against the company.

- ***A Canadian accounting firm and its current and former managing partners were charged by the SEC for violating auditor independence standards.*** According to the release, the accounting firm violated SEC and PCAOB audit partner rotation and auditor independence requirements during several audits between 2019 and 2023. The release alleges that the firm's independence was impaired during 11 annual audits and 26 interim reviews that the accounting firm conducted during the five-year period as a result of the accounting firm's deficient system of quality controls and lack of proper management oversight. The two managing partners included in the release were a part of the firm's Executive Committee charged with implementing necessary procedures to ensure compliance with audit partner rotation and auditor independence standards. The Commission acknowledged that the firm performed an internal review of audit engagements, promptly reported violations it discovered, and enhanced its controls related to audit partner rotations. The SEC required the firm to commit to certain undertakings, such as hiring a qualified consultant to evaluate its partner rotation controls and implementing recommendations made by the consultant. The Commission imposed a cease-and-desist order against the firm, ordering it to pay a total of \$265,000 in civil money penalties. The SEC also imposed a cease-and-desist order against the current and former managing partners, ordering them to pay \$25,000 and \$20,000 in civil money penalties, respectively.

“The PCAOB’s standards drive everything an auditor does; it’s the playbook so to speak. It is what the Board’s inspectors inspect against and what the Board’s enforcers enforce against. Thus, independence in standard-setting is paramount, to avoid conflicts of interest and ensure the needs of all the stakeholders are met. Without robust standards, the other two prongs – inspections and enforcement – have limited effectiveness.”

Paul Munter

SEC Chief Accountant

October 30, 2024

Remarks before the 2024 PCAOB International Institute on Audit Regulation: Robust Auditing and Quality Control Standards – the Foundation for an Effective Regulatory Regime

Rule 102(e) Actions

The SEC released five AAERs this quarter related to Rule 102(e) Actions, which involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC. Three of these releases are summarized below:

- ***The Commission suspended a Florida-based accountant for reporting fictitious revenue in the company’s public filings and failing to include certain required disclosures.*** The accountant was the founder, President, CEO, CFO, and sole officer of an internet-based platform that matched lenders with prospective borrowers. The SEC alleges that the revenue reported in the company’s Form 10-Qs in each of the first three quarters of 2019 was either fictitious or did not meet GAAP revenue recognition requirements. Additionally, despite being the majority shareholder, the accountant failed to make the required disclosures regarding his beneficial ownership of the company. As a result of these alleged actions, he has been denied the privilege of appearing or practicing before the Commission as an accountant.
- ***The Commission suspended a Florida-based public accounting firm and its founding partner for failing to perform an audit in accordance with professional accounting standards.*** According to the two releases related to this matter, the firm allegedly failed to exercise due professional care and skepticism during a 2020 audit for which the founder served as the engagement partner. Specifically, during the audit, the engagement partner allegedly observed inconsistencies and contradictory evidence provided by its client regarding a related-party sale and did not request or obtain additional audit evidence that supported the information surrounding the sale. The releases also allege that the engagement partner misrepresented the timing of the sale to the audit engagement quality control reviewer, and an unqualified audit opinion was ultimately issued. Both the firm and the engagement partner have been denied the privilege of appearing or practicing before the Commission as an accountant. Additionally, the accounting firm was ordered to pay a \$75,000 civil money penalty and the accountant was ordered to pay a \$50,000 civil money penalty.

FCPA Violations

There were five FCPA-related releases in Q4 2024, the most FCPA-related releases in any quarter since the third quarter of 2018. Summaries of three of the releases are below:

- The SEC issued a cease-and-desist order against a company that provides aerospace and defense systems to military and government customers for violating FCPA provisions related to anti-bribery, books and records, and internal accounting controls.*** The company, which was formed as a result of a merger and a name change in 2020 and 2023, respectively, offers services and products in approximately 180 countries and employs approximately 180,000 people in more than 50 countries. From 2011 through 2017, pre-merger, one of the parties (“Company 1”) allegedly paid bribes totaling nearly \$2 million to foreign military and government officials to obtain certain military defense contracts through fictitious subcontracts and suppliers. The release also alleges that from the early 2000s through 2020, Company 1 paid more than \$30 million to an individual and relative of the current Qatari Emir (head of state of Qatar), in connection with obtaining additional defense contracts. This individual had no prior background in military defense contracting and provided very little support for work performed to Company 1. According to the release, activity reports related to the contracts were “ghost-written” by a Company 1 employee until 2022. The release describes the payments as creating a significant anti-corruption risk that led to inaccurate company records and a “wholesale breakdown” of the company’s due diligence process and internal accounting controls, resulting in Company 1 being unjustly enriched by approximately \$37 million. The release cites a period of uncooperativeness by Company 1, but post-merger, the company has since demonstrated significant cooperation under new management and new outside counsel. The SEC ordered the company to pay over \$37 million in disgorgement, nearly \$12 million in prejudgment interest, and \$75 million in civil monetary penalties. The civil monetary penalties may be offset by \$22.5 million as a result of Company 1’s three-year deferred prosecution agreement with the Department of Justice (“DOJ”), where it agreed to pay a criminal fine of over \$230 million and forfeit nearly \$37 million.
- A global technology designer and provider was charged by the Commission for making improper payments to foreign officials and violating FCPA provisions related to maintaining proper books and records and internal controls.*** According to the release, between 2020 and 2022, the company’s India-based subsidiary made payments through a third-party agent to government officials to secure a sought-after supplier contract with a state-owned railway. The third-party agent facilitated these payments in exchange for 10% of the contract value. According to the release, the company’s subsidiary made similar payments to a government-owned aerospace and defense company in 2021 to secure a separate contract. SEC alleges that the company was unjustly enriched by over \$500,000 as a result of the subsidiary’s conduct. The SEC acknowledged the company’s cooperation and prompt remedial measures and ordered the company to pay a civil monetary penalty of \$1.1 million, disgorgement of approximately \$505,000, and prejudgment interest of approximately \$79,000.
- The SEC imposed a cease-and-desist order against an aviation services provider and a former executive for their involvement in bribing foreign officials.*** According to the two related releases, the company engaged in two separate bribery schemes in which a former executive played an instrumental role, involving improper payments to government officials that were falsely recorded on the company’s books as legitimate expenses. The first scheme involved payments made to Nepalese government officials from 2015 through 2018 to secure a lucrative contract with a government-owned airline. The release alleges that these payments resulted in the company’s unjust enrichment of \$6 million. Additionally, the former executive received approximately \$131,000 as compensation from the company for his part in winning the contract. The second scheme occurred from 2016 through 2020 and involved payments made to South African government officials to win a highly competitive contract with a state-owned airline. The release alleges that these payments resulted in the company’s

“Enforcement staff have used their judgment wisely and appropriately, conducting investigations diligently, but with urgency, and without fear or favor, following the facts where they may lead, to protect investors across the industry. That is, after all, our mission, and this Commission and its Enforcement staff have endeavored to fulfill it on a daily basis.”

Sanjay Wadhwa

Acting Director, SEC Division of Enforcement

November 15, 2024

Remarks at PLI’s 56th Annual Institute on Securities Regulation

unjust enrichment of approximately \$17.5 million. The Commission acknowledged the company's remedial efforts, which it enacted as soon as it became aware of the potential misconduct. This included cooperating with the SEC's investigation and enhancing its anti-corruption controls. The SEC did not impose civil monetary penalties, but did order the company to pay disgorgement of approximately \$23.5 million and prejudgment interest of nearly \$6 million. The Commission also ordered the former executive to pay approximately \$131,000 in disgorgement and nearly \$54,000 in prejudgment interest. Separately, the company agreed to pay a criminal penalty of over \$26 million as part of an agreement with the DOJ and the former executive agreed to pay a forfeiture of approximately \$131,000 as part of a guilty plea with the DOJ.

Reinstatements

Four releases this quarter related to individuals who were reinstated to appear and practice before the Commission as accountants. Below is a summary of two of the releases:

- A CPA was reinstated after previously engaging in improper professional conduct in connection with an audit for which he had supervisory responsibility.*** A CPA served as a senior manager on a 2017 audit and oversaw junior team members to ensure the audit complied with PCAOB standards. The release alleges that the former CEO of the audit client misappropriated nearly \$1 million in company funds and, according to the release, the senior manager observed certain material weaknesses in the company's internal controls and multiple red flags related to the misappropriation fraud throughout the audit. Despite these observations, the CPA did not conduct additional audit steps to adequately assess the materiality of the transactions and failed to obtain appropriate audit evidence, prepare sufficient audit documentation, and exercise due professional care and skepticism. The audit client ultimately received an unqualified opinion that was included in its 10-K filing for fiscal year 2017. In September 2020, the CPA was suspended from appearing or practicing before the Commission as an accountant for at least two years. More than four years later, the SEC granted the CPA's reinstatement request and the CPA was reinstated to appear and practice before the Commission as a person responsible for the preparation or review of financial statements required to be filed with the Commission, other than as a member of an audit committee. The release notes that going forward, his work must be reviewed by the independent audit committee of any company for which he works.
- CPA was reinstated following previous failures to comply with generally accepted auditing standards ("GAAS") while serving as the engagement partner of an audit.*** According to the original release, the CPA approved the issuance of an audit report in 2015 that contained several GAAS violations. These violations included the failure to i) obtain appropriate audit evidence; ii) prepare sufficient audit documentation; iii) examine journal entries for evidence of fraud; iv) assess the risk of material misstatement; v) communicate audit challenges to those responsible for governance; vi) properly supervise the audit; and vii) exercise due professional care and skepticism. As a result, in September 2021, the CPA was suspended from appearing or practicing before the Commission as an accountant for at least three years. The CPA was reinstated to appear and practice before the Commission as a person responsible for the preparation or review of financial statements required to be filed with the Commission, other than as a member of an audit committee. The release notes that going forward, his work must be reviewed by the independent audit committee of any company for which he works.

"Accountants serve as important gatekeepers to promote the integrity of our markets and protect investors regardless of whether they are internal or external auditors, preparers, tax professionals, audit committee members, or serve in other roles."

Paul Munter

SEC Chief Accountant

December 9, 2024

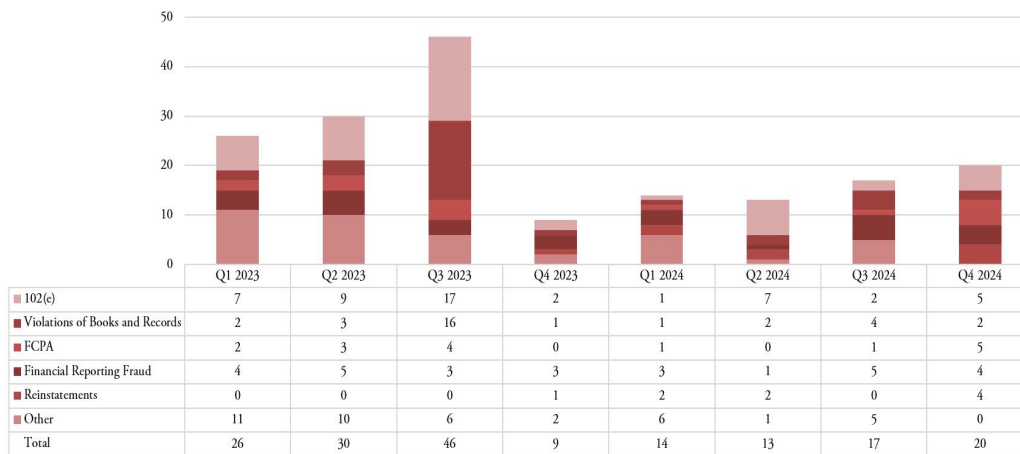
Remarks before the 2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments: Accounting Matters

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 the definitions provided by the SEC for the various AAER classifications. With that said, comparisons of the number of AAERs between periods can be a useful gauge of the SEC’s activities.

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

Quarter to Quarter AAER Comparison
Q1 2023 through Q4 2024



Based on the releases during this period, we made the following observations:

- The total number of releases this quarter (20) is notably higher than the average number of Q4 releases for the prior five years (14).
- There were 15 releases categorized as Rule 102(e) Actions in calendar year 2024 (23% of total releases), a decrease from the 40 Rule 102(e) Actions in the prior calendar year 2023 (32% of total releases).
- There were five releases categorized as FCPA-related in the fourth quarter of 2024, accounting for 25% of releases in this quarter. Of note, this is a significant increase from the average percentage (6%) across the seven preceding quarters.
- In contrast to only one Reinstatement being issued in calendar year 2023, there were eight Reinstatements issued in calendar year 2024, four of which were issued in the fourth quarter.

“In today’s market environment, not only are we conducting examinations in traditional areas, but we’re also examining for compliance with newly effective rules, looking ahead to changes in technology, dealing with some of the same cyber issues that each of you face every day, and considering the implication of recent advances in crypto assets and artificial intelligence.”

Keith E. Cassidy

Acting Director, SEC Division of Examinations

November 7, 2024

Compliance: Staying on Mission

Notable Q4 2024 AAER for “Recommended Reading”

While reviewing all 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 grant these particular releases the distinction of “Recommended Reading.” This quarter, we chose to highlight a Financial Reporting Fraud release related to one of the world’s largest package delivery companies.

Accounting and Auditing Enforcement Release No. 4542 / November 22, 2024, In the matter of United Parcel Service, Inc. (“UPS”)

UPS Settles with SEC for \$45 Million; Possible Actions to Follow

The SEC recently issued a release regarding the settlement of an action against UPS related to its failure to timely record the write down and impairment loss for the goodwill asset on its balance sheet for the UPS Freight business unit. The settlement involved a \$45 million civil money penalty along with other requirements, including an obligation to cooperate in future proceedings.

According to the AAER, UPS possessed internal analyses and market information that an impairment loss was necessary in 2019. However, rather than recognize the loss, UPS engaged a valuation consultant to prepare a report based on faulty assumptions that would support the overstated goodwill balance.

Of significance, UPS’s internal analyses and market information were correct, as UPS sold the business unit in the fourth quarter of 2020 and recorded an impairment loss for the entire UPS Freight goodwill balance of nearly \$500 million.

Below are select background facts from the AAER regarding UPS’s actions, a brief overview of GAAP guidance related to goodwill impairment tests, and a discussion of the roles and responsibilities of key parties responsible for UPS’s financial reporting. This latter discussion is especially relevant noting the cooperation requirement in the settlement.

Background

In 2019, UPS began a process to evaluate what to do with UPS Freight, a poorly performing business unit. UPS’s balance sheet during this period included a \$1.4 billion net-asset value for UPS Freight, including \$500 million of goodwill. However, also during this period, the UPS corporate strategy group estimated that UPS Freight would likely sell for \$350 million to \$650 million. Per GAAP, these facts indicated that a \$500 million impairment loss would be necessary in 2019.

Instead of recognizing the impairment loss, UPS engaged a valuation consultant to prepare calculations for the business unit’s fair value and provided flawed aggressive growth and costs assumptions and estimates. UPS did not share its internal analyses and market information with the consultant, which included for example, that “a prospective buyer would expect Freight to generate significantly less profit after it was sold because it would no longer benefit from synergies and other cost savings it was getting as part of UPS.” The consultant valued UPS Freight at \$2 billion.

“All investors should exercise good judgment, skepticism, and circumspection before putting their money at risk. To that end, the Commission plays an important role in ensuring that investors have the information they need to make thoughtful decisions in step with their goals and risk tolerance.”

Hester M. Peirce

SEC Commissioner

December 10, 2024

Arbitration, Alternative Assets,
and Aging Actors: Remarks at
the Meeting of the SEC Investor
Advisory Committee

UPS acted similarly in 2020, again providing flawed assumptions to the valuation consultant and without sharing its internal market analysis or that UPS began a process to sell UPS Freight in 2020. In fact, UPS executed a non-binding term sheet with a prospective buyer selling Freight for \$800 million, subject to various downward adjustments. Without knowledge of these events, the valuation consultant again valued UPS Freight at \$2 billion.

In the fourth quarter of 2020, after reaching an agreement to sell UPS Freight for approximately \$650 million, UPS reported that the UPS Freight goodwill was worthless. The \$500 million impairment loss reduced UPS's fiscal year 2020 income from continuing operations by approximately 6%, and its net income by approximately 20% percent.

Goodwill Impairment Testing Requirements

Guidance related to the financial reporting for goodwill is found in ASC 350 (Intangibles – Goodwill and Other) and requires entities to periodically test the carrying value of goodwill on its balance sheet, by reporting unit, to determine if it is stated at an amount greater than its “fair value.” ASC 350 further provides that fair value shall be determined in accordance with ASC 820 (Fair Value Measurement) which defines the term “fair value” as synonymous with a sale or exit price and that its determination shall be based on “assumptions market participants would use in pricing the asset or liability.”

When the carrying value of a reporting unit that includes goodwill exceeds the fair value, a registrant should record an impairment loss and reduce goodwill by the difference or in its entirety.

Roles and Responsibilities for UPS's Financial Reporting

Based on the facts described in the AAER, there are notable concerns related to the major parties with roles and responsibilities for UPS's financial reporting for goodwill.

Management

Financial statements are the responsibility of a registrant's management. According to the AAER, certain members of UPS management knew that an impairment loss was necessary, but instead, UPS chose to rely on a valuation consultant's calculations, after withholding information from the consultant and providing faulty assumptions to the consultant.

Valuation Consultants

Registrants frequently engage valuation consultants to assist management fulfilling their responsibilities for the financial statement judgments when presenting financial reporting assertions involving fair value. The consultants have no direct responsibility for the financial statement assertions. That said, they are expected to perform their services competently and in accordance with professional standards.

While management integrity appears to be lacking in its dealings with the consultant, the facts also indicate the consultant failed to perform calculations for UPS Freight's cost structure as a standalone business and as a unionized operation. Both flaws resulted in overstating the valuation.

“Let me be clear: promoting financial resiliency is at the core of the SEC's mission. In normal times, it helps promote trust in capital markets. In times of stress, it protects investors, issuers, and markets alike.”

Gary Gensler

SEC Chair

December 6, 2024

Remarks before the Financial Stability Oversight Council: 2024 Annual Report

Audit Committees

Audit committees are a select group of members of the board of directors that meet independence requirements and possess financial reporting expertise. The audit committee provides an oversight function for a registrant's financial reporting and internal controls.

While the AAER does not discuss the role of the audit committee related to the timing of the impairment loss, as members of the board, one would assume the committee had knowledge regarding UPS Freight's performance and planned divestiture. If so, one would expect the audit committee to ask targeted questions regarding whether the business unit's reported goodwill is impaired or not.

Auditors

Auditors plan and perform tests and procedures to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Auditors evaluate the accounting principles used by the registrant and the significant estimates made by management. Goodwill is an estimate and requires periodic testing to ensure its continued existence or impairment.

In the ordinary course, UPS's auditor would review and test the valuation consultant's assumptions and calculations, and if true for UPS, would mean the flaws described by the SEC related to the consultant's calculations would also be possible failures by the auditors to properly test for the existence of an impairment loss. In addition, the auditors would be aware of UPS Freight's performance, a major factor when evaluating the business unit's goodwill.

Possible Actions to Follow

The settlement includes a requirement for UPS to "cooperate fully with the Commission in any and all investigations, litigations, or other proceedings relating to or arising from the matters described in the Order." To use the accounting parlance of remote, possible, and probable, the combination of the facts in the AAER, and this clause, appears to meet the possible level, if not even the probable level, that additional actions from the SEC will follow.

"Investor confidence that all issuers are abiding by the highest standards of financial reporting depends on auditors fulfilling their duty as gatekeepers and being held accountable when they fall short of meeting their obligations."

Jaime Lizárraga

SEC Commissioner

December 18, 2024

Integrity and Transparency in
Financial Reporting: the PCAOB's
FY 2025 Budget

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ACKNOWLEDGEMENT

We wish to acknowledge the valuable contribution to this analysis by Amanda Savona, Libby Tagliaferro, and Joseph Floyd.

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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 & compliance, strategy & valuation, litigation services, and data analytics.

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