



*Summary of Accounting and
Auditing Enforcement Releases
for the Quarter Ended
March 31, 2023*

Q 1 R E P O R T 2 0 2 3

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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 ended March 31, 2023.

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
APRIL 2023

Highlights:

- The SEC released a total of 26 AAERs in Q1 2023, more than double the number of releases in Q1 2022 and four times the number of releases in Q1 2021. Notably, this is the first quarter since Q1 2021 in which there were no releases related to Reinstatements.
- The SEC imposed penalties totaling nearly \$50 million this quarter, including \$15 million against a metal and mining company for violating the books and records and internal accounting controls provisions of the FCPA in a bribery scheme in Guinea. Prior to this quarter, the SEC has only issued one FCPA-related AAER since Q3 2021.
- Of note, there were four AAERs related to Financial Reporting Fraud this quarter totaling \$26 million in penalties, compared to no Financial Reporting Fraud AAERs last quarter or in Q1 2022.
- Our Recommended Reading section highlights a Financial Reporting Fraud AAER in which inadequate internal controls resulted in an information technology and consulting company materially misstating non-GAAP measures to investors. This section describes the company's internal control deficiencies, summarizes the importance of non-GAAP reporting and disclosures, and provides recommendations that can help prevent other companies from facing similar issues.

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. 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.

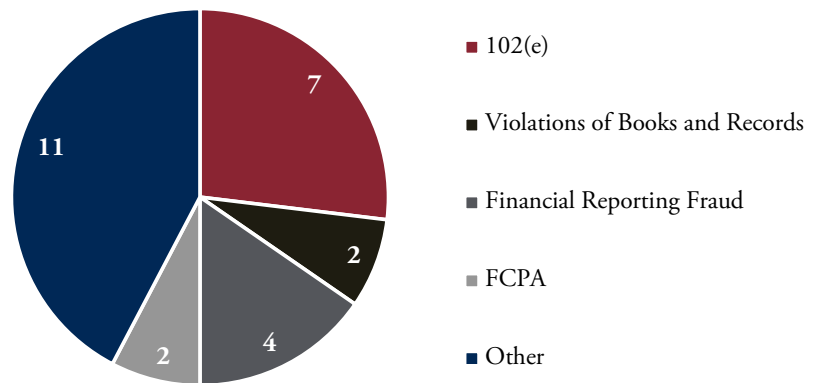
As part of our review, we gathered information and key facts, identified common attributes, and noted trends. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (i.e., Rule 102(e) Actions, Violations of Books and Records, Financial 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 report, and alternative methods of communication.

The Q1 2023 AAERs: Summary by Category and Insights from the Releases

The SEC released 26 AAERs during Q1 2023. Notably, nearly half of the AAERs this quarter were categorized as Other, while Rule 102(e) AAERs were the second most prevalent category, as depicted in the graph below:

Q1 2023 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 as an enforcement agency.

Rule 102(e) Actions

Seven AAERs related to Rule 102(e) Actions were released 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 the releases reported in this quarter’s Rule 102(e) Actions include the following:

- The SEC suspended a CFO for embezzling funds and making false representations to investors.*** According to the original complaint, the CFO of a special purpose acquisition corporation (“SPAC”) embezzled company funds and used them to pay personal expenses and trade in traditional and crypto asset securities. The CFO allegedly “erased” personal wire and transaction details on the company’s bank statements before providing them to external auditors. During the same period, the CFO raised money from investors for the purpose of launching another series of SPACs, however, all the funds were used to pay the CFO’s personal expenses, fund his securities trading, and replenish the company’s account to replace the embezzled funds. As a result, the company disclosed its findings and restated its financial statements. The CFO has been suspended from appearing or practicing before the Commission as an accountant. In a previous release, the CFO was ordered to pay disgorgement including prejudgment interest and civil monetary penalties totaling approximately \$10 million.

“Audit committees, issuers, and auditors all have crucial roles to ensure high quality financial reporting for the protection of investors. The expectation is that the level of audit quality in audits involving other auditors should be consistent and robust. The relevant risks should be considered and the appropriate PCAOB standards must be applied in order to strengthen lead auditors’ supervision over the work of other auditors, within and outside of network firms, to help enhance audit quality.”

Paul Munter,
Chief Accountant
March 17, 2023
Responsibilities of Lead Auditors to
Conduct High-Quality Audits When
Involving Other Auditors

- ***The SEC ordered cease-and-desist proceedings against a CPA firm and its owner for various audit failures.*** The release alleges that in 2016, a CPA firm and its sole owner, a CPA (collectively, the “Respondents”), accepted an engagement to audit the financial statements of a public company, despite having never played a substantial role in the audit of a public company before. From 2016 through 2018, the Respondents allegedly engaged and relied heavily on contract auditors to assist them. The assets of the audit client allegedly experienced various triggering events that require testing for both recoverability and impairment losses. The release states that the audit was ultimately deficient as there was no evidence that the Respondents (or contract auditors) performed procedures related to the recoverability of certain assets or considered assets subject to impairment in the planning and risk assessment stages of the audit. Furthermore, the Respondents allegedly failed to evaluate the results of their audit procedures, as there were clear inconsistencies and errors present in the financial statements. They also failed to prepare audit documentation that provided a clear description of the work performed and the conclusions reached.
- ***The Commission suspended a CFO for using company funds to pay personal expenses.*** According to the original complaint, the CFO of an advertising company knowingly and improperly used company funds to pay personal expenses. The company lacked sufficient controls over both cash withdrawals and corporate expense reimbursements, allowing personal expenses to be improperly included in the company’s books and records. The release further alleges that the CFO aided and abetted the company’s filing of misleading proxy statements in 2015 and 2016 by not properly disclosing personal expenses of the company’s executives as compensation. The CFO was suspended from appearing or practicing before the Commission as an accountant.

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 problems deemed worthy of an enforcement action but not meriting financial reporting fraud. A summary of one of the Violations of Books and Records releases this quarter is outlined below:

- ***The Commission imposed a cease-and-desist order against a manufacturing company and its Chief Accounting Officer (“CAO”) for improperly estimating bonus accruals and failing to maintain proper internal controls.*** The release alleges that from Q3 2015 through Q2 2018, the CAO of a manufacturing company improperly adjusted bonus compensation accruals without performing or documenting the necessary accounting analysis required under GAAP. The CAO directed the accounting staff to make a \$200,000 accrual reduction after determining that his original accrual estimate would lead the company to missing consensus earnings per share (“EPS”) estimates by \$0.01. Additionally, the release alleges that the company failed to create and/or maintain a sufficient system of internal accounting controls surrounding the closing process, including the accounting for bonus compensation, and failed to maintain internal controls over financial reporting. The SEC imposed a \$4 million civil money penalty against the company and a \$75,000 penalty against the CAO.

Financial Reporting Fraud

Four AAERs were categorized as Financial Reporting Fraud during the quarter and accounted for more than half of the total penalties imposed this quarter. Below are two examples of releases within this category, and a third release is described in our Recommended Reading section below:

“We continue to observe shortcomings related to the lead auditor’s performance of its responsibilities in planning, supervising, and evaluating the work performed by other auditors, including in engagements involving the use of network-member other auditors.”

Paul Munter,
Chief Accountant
March 17, 2023
Responsibilities of Lead Auditors
to Conduct High-Quality Audits
When Involving Other Auditors

“In times of increased volatility and uncertainty, we at the SEC are particularly focused on monitoring for market stability and identifying and prosecuting any form of misconduct that might threaten investors, capital formation, or the markets more broadly. Without speaking to any individual entity or person, we will investigate and bring enforcement actions if we find violations of the federal securities laws.”

Gary Gensler,
Chair of the SEC
March 12, 2023
Statement on Current Market
Events

- ***The Commission imposed a cease-and-desist order against a shipping and logistics company for using fraudulent accounting techniques.*** According to the release, from at least 2013 through 2017, a shipping and logistics company engaged in a multi-year fraud scheme by manipulating financial reports to reach analyst earnings projections. The company allegedly attempted to disguise its underperformance by improperly deferring certain expenses and recognizing them in multiple future quarters to avoid write-downs of worthless assets and uncollectable receivables. It also manipulated earnout liabilities, which essentially created an income reserve to be used in future quarters to offset expenses. Additionally, the release notes that the company concealed its fraud from its external auditor. As a result, the company's financial results in its earnings releases, earnings calls, and quarterly and annual reports from at least Q2 2013 through Q3 2016 were materially misstated. The SEC ordered the company to pay \$9.6 million in disgorgement and prejudgment interest, however, deemed the amount satisfied by the company's \$20 million class action lawsuit settlement payment in 2019. The class action lawsuit was based on the facts that gave rise to the company's restatement and alleged violations of securities laws.
- ***The Commission charged a water treatment company and its former finance director with fraudulent accounting practices that led to the reporting of materially false revenue amounts.*** The Commission's original complaint alleges that from 2016 through 2018, a finance director inflated a water treatment company's reported revenue by improperly recognizing revenue from bill-and-hold transactions earlier than permitted as the transactions did not meet the necessary criteria for immediate revenue recognition. The complaint further alleges that the improper accounting practices were a result of negligence by those responsible for managing financial reporting and accounting controls, and the company ultimately misled investors by reporting nearly \$12 million of additional revenue in its 2017 registration statement and its IPO. The SEC ordered that the company implement recommended improvements to its system of internal controls and pay a civil penalty of \$8.5 million. The finance director was also ordered to pay disgorgement, prejudgment interest, and a civil penalty in amounts to be determined by the court. Additionally, the court will consider whether he should be barred from serving as an officer or director of a public company in the future.

FCPA Violations

There were two FCPA-related releases in Q1 2023, resulting in \$19 million in civil penalties. Below is a summary of one of the releases:

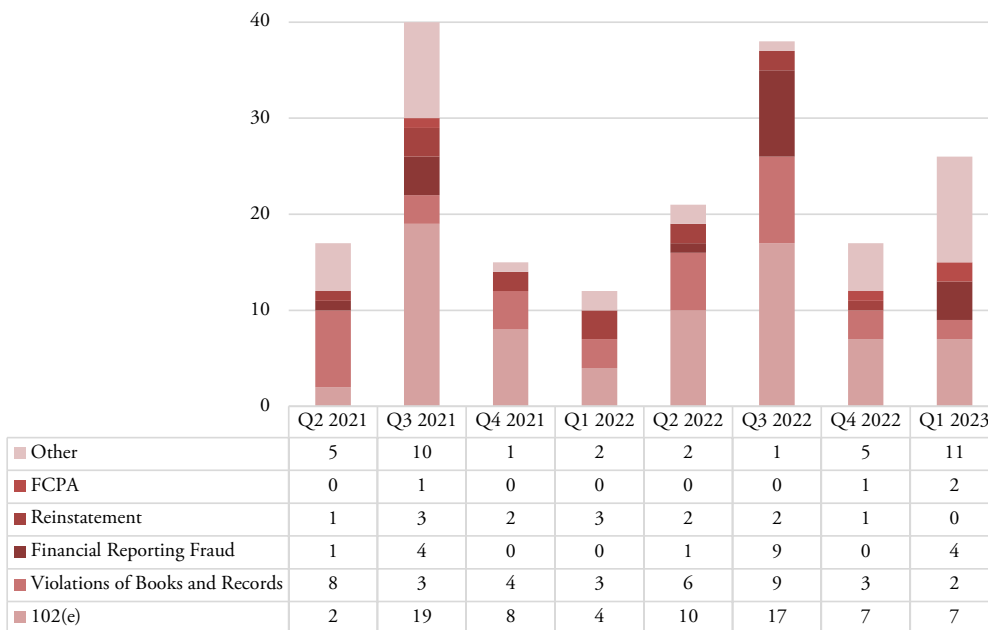
- ***A metal and mining company violated the books and records and internal accounting controls provisions of the FCPA through a bribery scheme in Guinea.*** According to the AAER, a metal and mining company hired a consultant in 2011 with close ties to a former senior government official in Guinea to help the company retain certain mining rights there. The company made payments totaling \$10.5 million to the consultant, but failed to conduct the required due diligence before retaining this consultant and did not prepare a written agreement defining the scope of services to be performed or the deliverables to be prepared. According to the release, the consultant, acting as an agent of the company, offered and attempted to make a payment to a Guinean government official in an effort to retain mining rights. The AAER notes that the company failed to maintain sufficient internal controls to detect or prevent this type of activity and was ordered by the SEC to pay a \$15 million civil money penalty. The company cooperated with the SEC's investigation and undertook various remedial efforts to strengthen its ethics and compliance areas of the business, including updating its policies and procedures related to due diligence and the use of third parties, enhancing its whistleblower program, anticorruption risk assessments and transaction testing of compliance controls, as well as training of employees and third parties on anti-bribery issues.

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. With 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
Q2 2021 through Q1 2023



Overall, based on the data above, we made the following observations:

- The number of AAERs released in Q1 each year has doubled during each of the last three years, with 26 AAERs in Q1 2023, 12 in Q1 2022, and six in Q1 2021.
- Rule 102(e) sanctions continue to make up a significant percentage of the AAERs, averaging 38% of the total AAERs over the eight-quarter period.
- There were no Reinstatement AAERs released in Q1 2023, a departure from recent trends in which there have been an average of two per quarter since Q2 2021.

Notable Q1 2023 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 deem these particular releases as earning the distinction of “Recommended Reading” for our clients. This quarter, we chose to highlight a release that describes the many benefits of effective internal controls, not just those related to GAAP.

Accounting and Auditing Enforcement Release No. 4391 / March 14, 2023, In the Matter of DXC Technology Company

Internal Controls Are Not Just for GAAP Reporting

Internal Controls Matter

Internal controls over financial reporting (“ICFR”) are generally considered to be the policies and control procedures that provide reasonable assurance to a user that a company’s financial statements are reliable and prepared in accordance with GAAP.

However, when registrants provide other financial information in their public filings, such as non-GAAP measures and metrics, these also require adequate controls to ensure reliability.

The recent AAER issued by the SEC announcing its settlement with DXC Technology Company (“DXC”), for which DXC paid an \$8 million fine as part of the settlement, is a great example of the consequences for not having adequate internal controls over non-GAAP measures included in public filings and press releases.

DXC is a multi-national information technology company that was created by the merger of Computer Sciences Corporation with most of the Enterprises Services business of Hewlett Packard Enterprise Company in April 2017.

Importance of Non-GAAP Measures to Investors

DXC presented non-GAAP measures to its investors as supplemental financial information to evaluate its core operating performance, excluding one-time or non-recurring expenses.

In its public filings and earnings releases, DXC noted that management believed “these non-GAAP measures allow investors to better understand the financial performance of DXC exclusive of the impacts of corporate-wide strategic decisions ... [and provide] investors with additional measures to evaluate the financial performance of [the] core business operations on a comparable basis from period to period.”

DXC management also believed that “the non-GAAP measures provided are also considered important measures by financial analysts covering DXC, as equity research analysts continue to publish estimates and research notes based on [the] non-GAAP commentary, including [the] guidance around non-GAAP EPS.”

DXC’s Failure to Maintain Adequate Control over Non-GAAP Reporting

According to the SEC, DXC made material misstatements in its reporting and disclosures of such non-GAAP financial performance measures, including non-GAAP net income and non-GAAP diluted EPS, in numerous public filings and earnings releases.

“Market entities across our capital markets increasingly rely on complex and ever-evolving information systems. Those who seek to harm these systems have become more sophisticated as well: in their tactics, techniques, and procedures.”

Gary Gensler,
Chair of the SEC
March 15, 2023
Statement on Enhanced
Cybersecurity for Market Entities

From the end of the company's fiscal year 2018 through the third quarter of its fiscal year 2020, DXC presented adjusted net income and adjusted earnings per share amounts after excluding costs that it deemed non-recurring, including transaction, separation, and integration-related ("TSI") costs. DXC described TSI costs as those "related to integration planning, financing, and advisory fees associated with" the merger that formed DXC, other acquisitions, and the spin-off of a business. The objective for the non-GAAP presentation was to provide investors with information about the performance of the core business.

However, DXC erroneously classified tens of millions of dollars of expenses as part of the TSI costs excluded from the adjusted results, thereby overstating such results, and providing misleading information to the market.

As the SEC notes, DXC had no formal guidance that employees could follow to determine which costs could be classified as TSI. In addition to a lack of clear guidance regarding what to include, there was also a failure by the controller's group to test the amounts identified as TSI by the Financial Planning & Analysis (FP&A) team.

As a result, DXC's non-GAAP disclosures did not comply with Rule 100(b) of Regulation G of the Exchange Act, which states:

A registrant, or a person acting on its behalf, shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of that measure, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.

While the AAER focuses on the adjusted non-GAAP measures as being misleading, from the description provided by the SEC, one could also categorize the amounts as "an untrue statement of a material fact."

Questions to Ask to Avoid Similar Problems

It is important to recognize that DXC is a large and sophisticated company, yet still made the errors described above. Unfortunately, the determination and presentation of the adjusted non-GAAP measures were likely considered simple calculations and received little attention.

Below you will find a list of questions to consider when assessing non-GAAP measures to avoid similar problems to those described above:

- Do we use non-GAAP measures?
- If so, is there a written policy on how to identify, calculate, and support the amounts?
- Who prepares the calculation and documentation?
- Who is tasked with testing and auditing the calculation and documentation?

There is not one person or one group responsible for the accuracy of non-GAAP measures. The accounting department, audit committee, disclosure committee, and senior management all have a shared responsibility. As mentioned above, DXC and other registrants who present non-GAAP measures believe "these non-GAAP measures allow investors to better understand the financial performance" of their company. As such, presenting amounts that are reliable is critical and requires adequate focus and internal controls.

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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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