Summary of Accounting and Auditing Enforcement Releases for the Quarter Ended September 30, 2023

Q3 REPORT 2023

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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" or "Commission") Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the quarter ended September 30, 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 interest. Our objective is to summarize and report on the major items reported 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
OCTOBER 2023

Highlights:

- **The SEC released 46 AAERs in Q3 2023, representing the highest number of AAERs released in a single quarter since Q3 2018. A significant increase in the number of AAERs released in the third quarter of a calendar year is not novel, as September 30th marks the end of the SEC's fiscal year and the date in which it "closes the books" and releases the results of its annual activities, including enforcement actions.**

- **This quarter, the SEC imposed penalties totaling nearly $250 million, including over $100 million against a specialty chemicals company for violating the anti-bribery, books and records, and accounting controls provisions of the Foreign Corrupt Practices Act ("FCPA"). The number of FCPA-related AAERs has continued to increase, with four releases this quarter.**

- **Notably, there were 16 releases related to Violations of Books and Records this quarter, which is the highest amount released in any quarter over the last ten years and only the third quarter with double digit releases over the same period.**

- **This is the third quarter in a row in which the SEC did not issue any Reinstatements to individuals to appear or practice before the Commission, which represents the longest timeframe without a Reinstatement AAER in over five years.**

- **Our Recommended Reading section this quarter examines how special accounting calculations require special controls, highlighting an AAER in which a manufacturing company failed to properly account for the sale and leaseback of assets, costs of services related to research and development, and loss accruals related to service contracts, among other issues. We provide an overview of the company, its accounting failures, the penalties and punishments imposed by the SEC, as well as recommended internal controls to avoid similar problems.**

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 or Practice before the SEC, FCPA Violations, and Other[1]). 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.

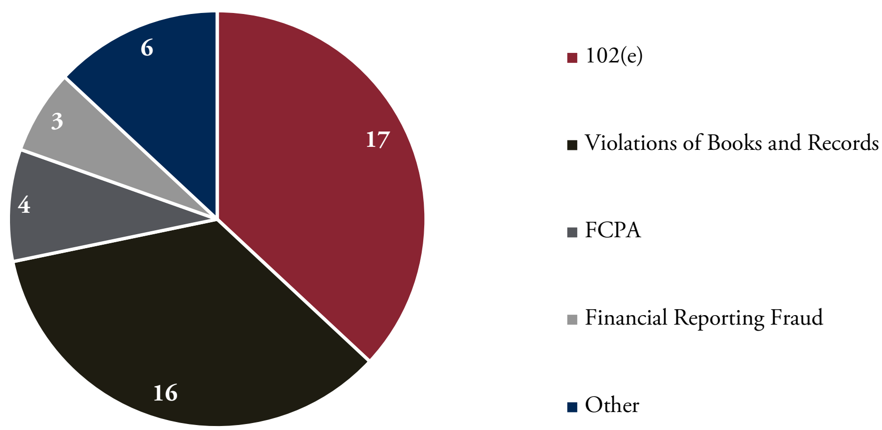
The Q3 2023 AAERs: Summary by Category and Insights from the Releases

"Risk assessment forms the basis of the audit process. A lack of professional skepticism, including objective consideration of contradictory information, in this critical process could result in an auditor not identifying or assessing risks appropriately, which could impact the effectiveness of the audit."

Paul Munter,
Chief Accountant
August 25, 2023
The Importance of a Comprehensive Risk Assessment by Auditors and Management

The SEC released 46 AAERs during Q3 2023, with Rule 102(e) Actions and Violations of Books and Records each representing over one third of the total releases this quarter. The following graph illustrates this quarter's total AAERs by category:

Q3 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

17 AAERs related to Rule 102(e) Actions were released this quarter, totaling over $1 million in penalties. Rule 102(e) Actions involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC. Two examples of the releases reported in this quarter's Rule 102(e) Actions include the following:

- ***The Commission suspended an individual serving as the interim contract CFO of a nutrition company for improper accounting practices that led to the reporting of materially false revenue amounts.*** According to the release, from 2017 through 2018, the interim contract CFO prematurely recognized revenue for orders before and during shipment to the customer instead of recognizing revenue after customer acceptance of delivery, as required by certain contracts. Furthermore, the interim contract CFO allegedly misclassified customer credits as advertising expenses, as opposed to reductions in revenue. As a result of these improper accounting practices, the company materially overstated their annual and quarterly revenue. The interim contract CFO was suspended from appearing or practicing before the Commission as an accountant and may apply for reinstatement after three years.

- ***The SEC suspended a director of a public accounting firm for performing unauthorized audits that were not in accordance with Generally Accepted Auditing Standards ("GAAS").*** The release alleges that from 2013 through 2019, the director performed numerous audits, despite not holding a valid CPA license since 2008. The director allegedly misrepresented to his clients that these audits were performed in accordance with GAAS, despite numerous violations including failures to obtain audit engagement letters, prepare audit documentation, and ensure proper review sign-off on workpapers and final reports. Furthermore, the release alleges that the accounting firm was unaware that the director was performing these audit engagements, and the director falsified invoices related to work performed for these clients to conceal these unauthorized audits. Finally, the director allegedly made misrepresentations about an unauthorized audit he performed for use in the due diligence process of a client's securities offering. The director was denied the privilege of appearing or practicing before the Commission as an accountant, and the SEC's order does not provide an express right to apply for reinstatement.

Violations of Books and Records

This quarter we categorized 16 AAERs as Violations of Books and Records, totaling over $17 million in penalties. This category includes alleged improper accounting treatments and internal control problems deemed worthy of an enforcement action but not warranting categorization as financial reporting fraud. Below are two examples of releases within this category, and a third release is described within our Recommended Reading section of this report:

- ***The Commission imposed a cease-and-desist order against a biotechnology company for its issuance of misleading press releases and failure to disclose related party transactions, maintain accurate books and records, and have appropriate disclosure controls and procedures.*** According to the release, the biotechnology company issued press releases on February 6 and 10, 2020 regarding a screening test it developed to detect COVID-19. The press releases allegedly misleadingly communicated that consumers could utilize the screening test to detect the virus, despite the test being intended for Research Use Only ("RUO") and not yet approved for sale to diagnose a patient. The biotechnology company subsequently offered and sold securities to investors based on this allegedly misleading information. In fact, the stock increased 19% on February 6 and 32% on February 10, 2020, as compared to the prior day, respectively. The release further alleges that the biotechnology company failed to disclose related party transactions involving the CEO, CFO, Secretary, and General Counsel in its 2018 through 2020 annual reports due to inadequate disclosure controls and procedures. The biotechnology company was ordered to pay a civil money penalty of $250,000.

"Timely and transparent reporting by management, and informative, accurate, and independent reports by auditors, are critical components of the system that help companies maintain their end of the bargain—their commitment to provide high quality financial information and information about the effectiveness of their ICFR to investors."

Paul Munter,
Chief Accountant
August 25, 2023
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- ***The SEC charged a manufacturing company and its former CEO for misleading investors about sales performance.*** The release alleges that from the third quarter of 2016 through the second quarter of 2017, the manufacturing company made misleading statements regarding non-GAAP financial measures that would allow investors to better understand sales trends. These statements were misleading as they did not disclose that sales growth rates were allegedly elevated because of actions of the former CEO. According to the release, to offset disappointing sales, the former CEO instructed employees to pull forward sales from future quarters, examine customer promotion accruals for potential reductions, and reclassify consideration payable to customers, and not deduct the consideration, as required under GAAP. As a result of this alleged misconduct, the manufacturing company reported strong sales growth to investors. The company and former CEO were ordered to pay civil money penalties of $12.5 million and $110,000, respectively.

Financial Reporting Fraud

Three AAERs were categorized as Financial Reporting Fraud during the quarter and accounted for more than $47 million in penalties. A summary of one of the Financial Reporting Fraud releases this quarter is outlined below:

- ***The SEC imposed a cease-and-desist order against a utility company for a multi-year scheme to corruptly influence and reward a politician for assistance with legislation affecting its business.*** The release alleges that from around 2011 through 2019, the utility company corruptly influenced and rewarded the then-speaker of the Illinois House of Representatives by arranging for various associates of the then-speaker to obtain jobs, vendor subcontracts, and monetary payments associated with these jobs and contracts in return for assistance with relevant legislation. As a result of this alleged misconduct, the utility company was ordered to pay a civil money penalty of $46 million.

FCPA Violations

The SEC issued four FCPA-related releases this quarter, resulting in over $175 million in penalties imposed by the SEC. Three examples of the actions reported in this quarter's FCPA releases include the following:

- ***A specialty chemical company violated the anti-bribery, books and records, and internal accounting controls provisions of the FCPA through a bribery scheme in Vietnam, India, and Indonesia.*** The release alleges that from at least 2009 through 2017, the chemical company's agents paid bribes to obtain sales of chemicals to public-sector refineries in Vietnam, India, and Indonesia, as well as to private-sector refineries in India. The chemical company allegedly ignored significant red flags indicating a high probability of bribery when retaining these agents, and these intermediaries subsequently made corrupt payments to government officials. The release further alleges that the company's books and records failed to adequately reflect or contain reasonable detail to support such payments. As a result of the alleged misconduct, the chemical company improperly obtained a benefit of approximately $82 million from these chemical sales. The chemical company was ordered to pay a $99 million criminal fine as part of its resolution with the U.S. Department of Justice as well as over $100 million in disgorgement and prejudgment interest to the SEC.

"Clear and transparent communication for the benefit of investors is critical. Management's financial reporting obligations include disclosures around its annual ICFR evaluations, descriptions of identified material weaknesses, and, on a quarterly basis, changes that have materially affected, or are reasonably likely to materially affect, an issuers' ICFR."

Paul Munter,
Chief Accountant
August 25, 2023
The Importance of a Comprehensive Risk Assessment by Auditors and Management

- ***A commercial banking group violated the anti-bribery provisions of the FCPA through its involvement in a bribery scheme related to the largest highway construction project in the history of Colombia.*** According to the release, the commercial banking group paid multiple bribes to secure and expand a highway construction project valued at over $1 billion. As a result of insufficient internal accounting controls, these bribes were allegedly concealed as legitimate business expenses in the company's books and records by using no-work contracts and sham invoices. Allegedly, throughout the several year bribery scheme, those involved were provided with an improper financial benefit in the form of fees, interest income, and investment distributions totaling approximately $32 million. As a result, the commercial banking group was ordered to pay a $20 million criminal fine as part of its resolution with the U.S. Department of Justice as well as over $40 million in disgorgement and prejudgment interest to the SEC.

- ***A manufacturing company violated the books and records and internal accounting control provisions of the FCPA through a bribery scheme in China.*** The release alleges that from at least 2014 through 2018, a Chinese-based subsidiary of a manufacturing company arranged for Chinese healthcare officials to attend overseas conferences, educational events, and healthcare facility visits as part of the company's marketing and outreach efforts. However, these events were allegedly a false pretext for the subsidiary to provide overseas travel, sightseeing, and entertainment to these officials in exchange for business from the officials' employers. The release alleges that to execute this scheme, the subsidiary transferred funds to a complicit China-based travel agency to help pay for these tourism activities. The release further alleges that these activities were improperly recorded in the subsidiary's books and records as legitimate business expenses, and then ultimately consolidated into the parent company's books and records, rendering them inaccurate. Additionally, the release notes that the parent company failed to create and maintain adequate internal controls surrounding the cross-border transfer of funds to vendors. As a result, the manufacturing company was ordered to pay disgorgement and prejudgment interest totaling over $4 million as well as a $2 million civil money penalty.

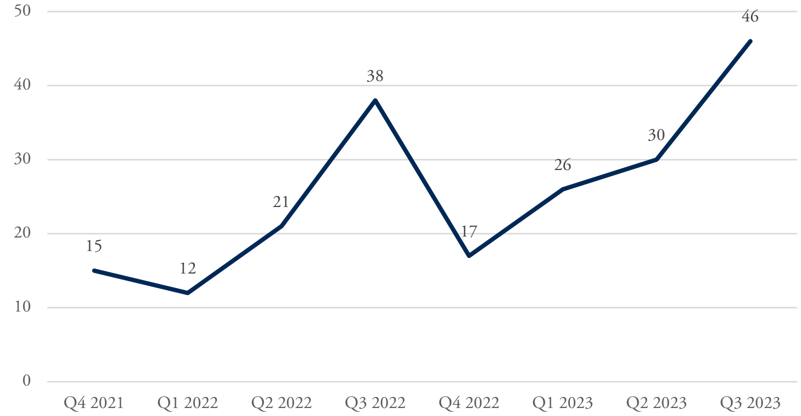
"We're updating our rules to promote the efficiency, integrity, and resiliency of the markets. We do so with an eye toward investors and issuers alike, to ensure the markets work for them and not the other way around."

Gary Gensler,
Chair of the SEC
September 12, 2023
Oral Testimony of Gary Gensler Before the United States Senate Committee on Banking, Housing, and Urban Affairs

Prior Period Comparison: Quarter to Quarter

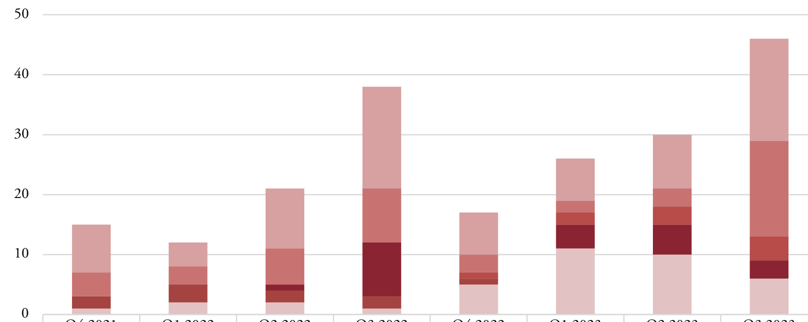
As described in the section titled "Our Process and Methodology," AAERs are intended to highlight certain actions, and they do not represent an exhaustive and complete compilation of all actions that fit into the definitions provided by the SEC for the various AAER classifications. With that said, comparisons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

Total Number of AAERs by Quarter



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

Quarter to Quarter AAER Comparison
Q4 2021 through Q3 2023



	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023
102(e)	8	4	10	17	7	7	9	17
Violations of Books and Records	4	3	6	9	3	2	3	16
FCPA	0	0	0	0	1	2	3	4
Financial Reporting Fraud	0	0	1	9	0	4	5	3
Reinstatement	2	3	2	2	1	0	0	0
Other	1	2	2	1	5	11	10	6

Overall, based on the data above and as mentioned previously, we made the following observations this quarter:

- The number of AAERs released in each quarter of 2023 continues to exceed the amount released in the respective quarters of 2022, with 46 AAERs in Q3 2023 as compared to 38 AAERs in Q3 2022;
- Rule 102(e) Actions continue to make up a significant percentage of the AAERs, accounting for the majority of the releases this quarter and averaging about 39% of the total AAERs over the eight-quarter period;
- The number of FCPA-related releases has continued to rise from 2022, with four FCPA-related AAERs in Q3 2023; and
- For the third quarter in a row, there were no AAERs released related to Reinstatements.

"The SEC is the cop on the beat watching out for your constituents. In the last year, we've filed approximately 750 enforcement actions and conducted approximately 3,000 examinations of registrants. We engage with more than 40,000 registrants—asset managers, brokers, dealers, exchanges, fund complexes, public companies, and many more."

Gary Gensler,
Chair of the SEC
September 27, 2023
Testimony Before the United States House of Representatives Committee on Financial Services

Notable Q3 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.

Accounting and Auditing Enforcement Release No. 4452 / August 30, 2023, In the Matter of Plug Power Inc.

Special Accounting Calculations Require Special Controls

The United States Securities and Exchange Commission recently issued an AAER announcing the settlement of an action with Plug Power Inc. ("Plug") related to several accounting errors in Plug's previously released financial statements. The settlement involved the imposition of a cease-and-desist order and a $1,250,000 civil penalty.

On May 14, 2021, Plug filed a Form 10-K for 2020 that included restated financial statements for 2018 and 2019 as well as for interim quarterly reports for 2019 and 2020. Plug is a public registrant with its shares trading on the NASDAQ exchange and is headquartered in Latham, New York. Plug provides green hydrogen and hydrogen-fuel-cell solutions for electric motors in supply chain and logistics applications, electric vehicles, stationary power, and other markets.

This restatement corrected Plug's accounting errors, including the failure to properly report the accounting for the sale and leaseback of assets, the misstatement of costs of services as research and development expenses, and the understatement of loss accrual amounts related to service contracts, among others. Importantly, the SEC's description of the errors never indicated intentional wrongdoing by anyone involved with Plug's accounting.

Of note, Plug's largest and most notable error related to the accounting for the sale and leaseback of assets. In fact, per Plug's restatement, its calculation error overstated its "right-of-use" ("ROU") assets and lease obligations as of December 31, 2019, by $112.7 million.

How it happened and how it went undetected are matters that registrants should consider if they rely on special accounting calculations when making financial reporting assertions.

Below is a brief description of the sale and leaseback accounting guidance, the facts related to the error as well as recommended controls to avoid similar errors.

"Accordingly, we are troubled by instances in which management and auditors appear too narrowly focused on information and risks that directly impact financial reporting, while disregarding broader, entity-level issues that may also impact financial reporting and internal controls. Such a narrow focus is detrimental to investors as it can result in material risks to the business going unaddressed and undisclosed, thereby diminishing the quality of financial information."

Paul Munter,
Chief Accountant
August 25, 2023
The Importance of a Comprehensive Risk Assessment by Auditors and Management

Overview of Sale and Leaseback Accounting

In a sale and leaseback transaction, a business sells an asset to a buyer, who is typically a financing entity, and the buyer then leases the asset back to the seller, who is now the lessee. The buyer secures legal title to the asset, while the seller maintains control of the asset under the lease. Of significance, the seller receives cash proceeds from the sale and the lease arrangement requires the seller, now lessee, to make future rental payments to the buyer, now lessor.

Guidance for how to record a sale and leaseback transaction is found in Financial Accounting Standards Board ("FASB"), Accounting Standards Codification ("ASC") Topic 842, titled Leases. Recording the sale transaction is rather straightforward, with the sales price represented by the cash proceeds received, the removal of the asset's basis from the books and records of the entity, with the difference being recorded as a gain or loss depending on the economics of the transaction.

Next the lessee will need to record the leased assets and liability on its books. The leased assets are referred to as "right-of-use" or "ROU" asset. The liability is referred to as a lease obligation. The amount to be recorded for these entries is calculated based on the present value of the future lease payments.

Of note, a special calculation is required for the present value of future lease payments, and is typically performed in a spreadsheet, with the result being used in the accounting entries.

Plug's Lease Obligation Calculation Includes Unrelated Payments

Plug engaged in sale and leaseback transactions by selling its hydrogen-power equipment to financial institutions and then leasing the equipment back, to be used to produce and sell power to customers under Power Purchase Agreements ("PPAs").

Plug also "sold" the future revenues to be received under the PPAs to financial institutions. Under these arrangements, Plug received cash from and incurred a liability to the financial institutions.

Therefore, Plug has two separate and different types of contracts, although both with financial institutions. Plug's error in calculating the present value of the future payments under the sale and leaseback transaction is that it added the future payments to be made related to the sale of PPAs, which it had already recorded as an obligation on its financial statements.

The error resulted in a double count for the latter liability, which materially overstated the value of the ROU assets and corresponding lease obligation. To correct this error, Plug removed the future payments related to the PPAs from the ROU asset and liability calculations.

"Management needs to be alert to new or changing business risks to identify changes that could significantly impact its system of internal control, and design and implement responses that support issuers' ability to appropriately disclose information in its periodic filings."

Paul Munter,
Chief Accountant
August 25, 2023
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Controls for Special Calculations to Avoid Similar Problems

As described above, accounting for the sale and leaseback transactions requires a special calculation to determine the amounts to record for the value of the ROU assets and the present value of the future payments related to those assets as a liability. The AAER does not provide specific information on how or whether Plug's calculation was tested, but it is likely Plug used a typical spreadsheet software, such as Excel.

Identifying the future payments and calculating a present value may sound simple, but what sounds simple can lead to a lack of proper scrutiny and overlooked risks.

For any calculation that will produce a result that will be used for financial reporting, there should always be controls and tests performed including:

- **Trace all amounts to supporting documents**, such as contracts, loan agreements, or other source materials;
- **Math check all results** and preferably manually as reliance on spreadsheet formulas can result in errors if the formulas are flawed;
- **Perform analytical tests** to judge the reasonableness of the calculation results and do not blindly accept the special calculation result as accurate; and
- **Document the controls and tests performed** along with an overall conclusion on the acceptability of the result for financial reporting purposes.

Spreadsheets for special calculations are regularly used in modern accounting systems. Of concern, their "appearance" of accuracy is often only that. It is important to identify all such calculations in your accounting system and inquire as to how the spreadsheet calculations are tested, and the results documented as fairly stated for financial reporting purposes.

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For more information, please contact LeeAnn Manning at 617.586.1076 or Meghan Morine at 646.449.7265.

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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