SEC Financial Reporting & Auditing Enforcement

Holland & Hart LLP

Review for Calendar Year

2014

First Half of

2015

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WELCOME

"The importance of pursuing financial fraud cannot be overstated. Comprehensive, accurate and reliable financial reporting is the bedrock upon which our markets are based because false financial information saps investor confidence and erodes the integrity of the markets."

- Andrew Ceresney, Director of the SEC's Division of Enforcement [1]

Welcome to Holland & Hart's Financial Reporting and Auditing Enforcement Review.[2] Public companies, officers and directors, audit firms, auditors, and securities practitioners alike can turn here for an insightful discussion of key Securities and Exchange Commission (SEC) enforcement cases and trends in this area.

Financial reporting and auditing matters have been a traditional area of focus for the SEC. Other than a brief resurgence with stock option backdating, however, news about these cases in recent years was overshadowed by headlines on other cases concerning the Financial Crisis of 2008, insider trading, and Ponzi schemes of all types.

Signaling a renewed focus on pursuing financial reporting and auditing enforcement cases, the SEC announced the formation of the Financial Reporting and Audit Task Force (the "Task Force") in mid-2013. The Task Force has been bolstered by tools used to automatically detect potential accounting anomalies (called the accounting quality model, or AQM). Yet due to the long tail of existing cases in the SEC's pipeline, calendar year 2013 is best viewed as a baseline against which future priorities and efforts may be compared.

By now, the SEC has had more opportunity to flex its financial reporting and auditing enforcement muscles. 2014 was the first full calendar year after forming the Task Force, and the initiative has reached two years old by mid-2015. Moreover, the Task Force faced its first leadership change, with the April 2015 announcement of the departure of Task Force chair David Woodcock (also Regional Director of the Ft. Worth Regional Office). Nevertheless, according to Chair White, the SEC's efforts are "starting to bear fruit."[3]

By now, the **SEC** has had more opportunity to flex its financial reporting and auditing enforcement **muscles**.

This enforcement review analyzes the SEC's continued focus on financial reporting and auditing cases during calendar year 2014 through June 2015. First, we "crunch the numbers" by analyzing the SEC's financial reporting and auditing cases from 2014 and early 2015 – comparing the results to prior metrics and examining interesting differences. Next, because "forewarned is forearmed," we explore takeaways and themes gleaned from the cases, public statements by the SEC staff and Commissions, and other developments in the public company and accounting arena.

I hope that you enjoy this second edition of the report as much as I enjoyed putting it together.[4] Please let me know your thoughts; I look forward to hearing from you.

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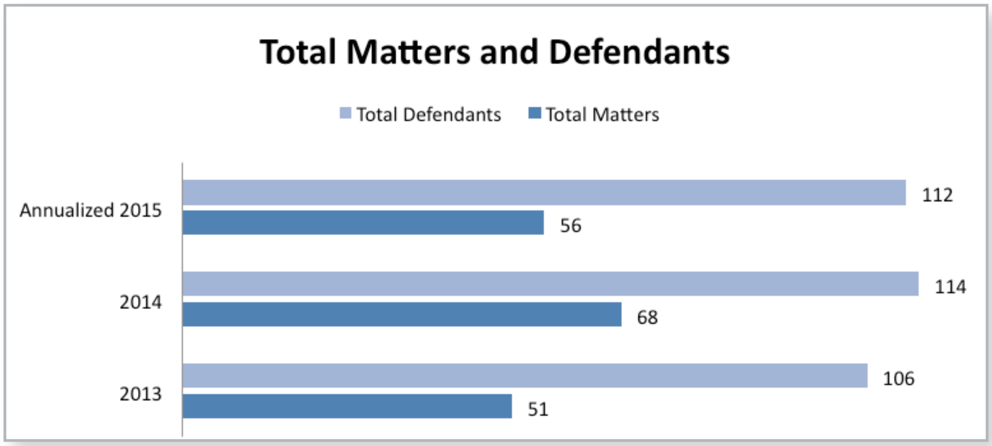
The SEC announced 68 new financial reporting and auditing matters involving 114 defendants during calendar year 2014.[5] As illustrated below, this represents an uptick from 2013's totals. The first half of 2015 is trending towards similar totals. Let's dig into the details.

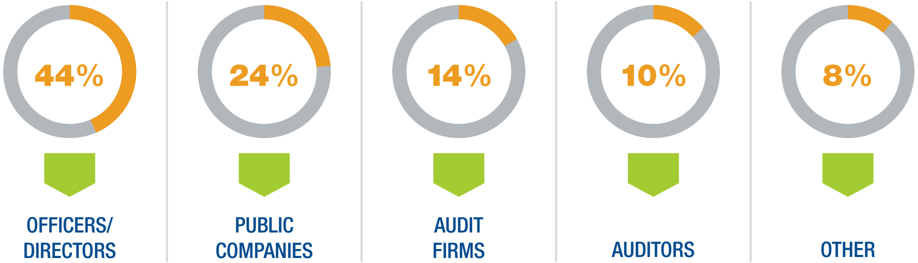


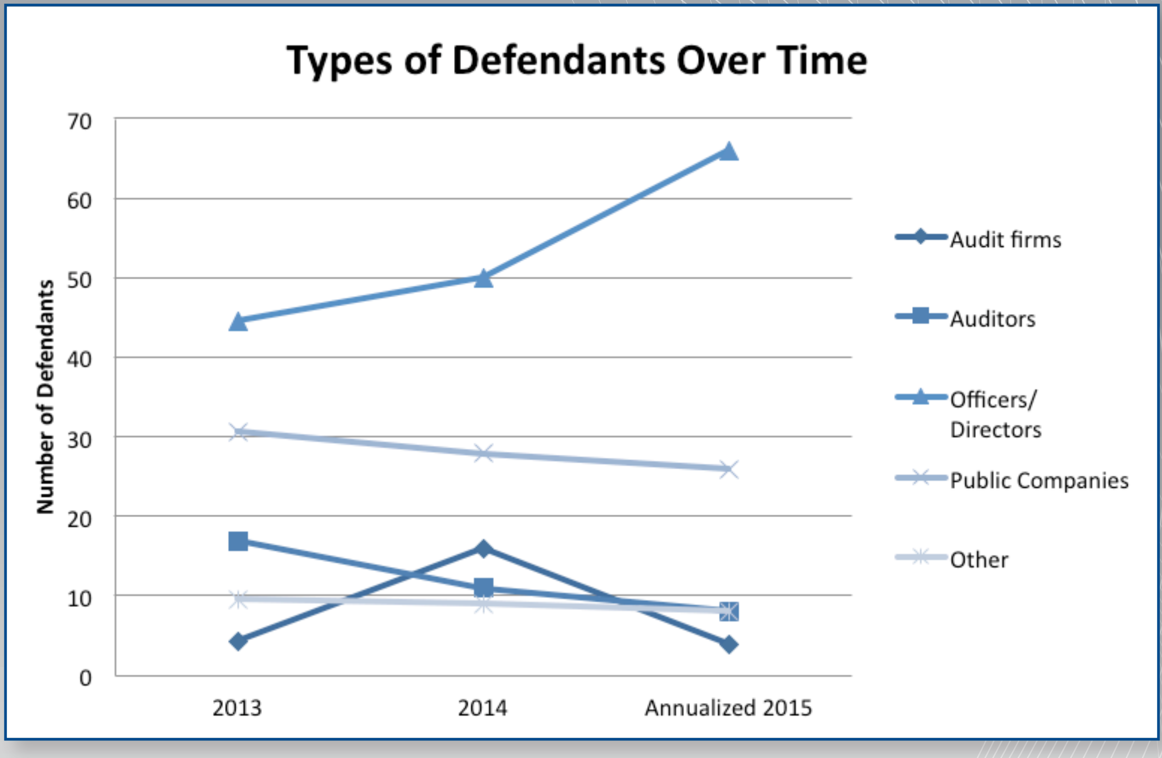
DEFENDANT TYPES

The SEC pursued claims against all types of entities and individuals. As illustrated below, the SEC's 2014 cases encompassed a variety of key players in the public company financial reporting and auditing process. The most significant difference between 2013 and 2014 defendant types lies with audit firms – the SEC sued significantly more audit firms in 2014. The percentage of auditing defendants more than tripled from approximately 4% in 2013 to approximately 14% in 2014. Indeed, as discussed in more detail below, 2014 may well go down as a watershed year for auditor enforcement. In contrast, the SEC sued relatively comparable percentages of other types of entity and individual defendants in 2013 and 2014.

The SEC's increased focus on audit firms comes as no surprise. SEC Commissioners and staff alike have touted the Division of Enforcement's close scrutiny of gatekeepers, such as audit firms. Director Ceresney, for example, proclaimed that investigating outside auditors occurs "in virtually every case."[6]

TYPES OF DEFENDANTS IN 2014 MATTERS





Annualizing the SEC's defendant types from the first half of 2015 reveals another striking trend – a significant uptick in the number of officers / directors sued. Perhaps 2015 will set new records in this area. Interestingly, the number of other defendant types sued in 2015 trend downward, but the SEC's actual cases announced during the second half of 2015 could ultimately smooth these current trend lines.

CASE SUBJECT MATTERS

As illustrated below, the SEC's cases in 2014 and the first half of 2015 generally fell into the same primary categories as in the prior years. Although certain cases fit into multiple categories, the cases are grouped below based on their apparent primary topic area.[7]

CASES BY PRIMARY SUBJECT MATTER

2013 2014 2015

Subject matter	Year	Cases	Defendants
REVENUE RECOGNITION	2013	3	5
	2014	14	32
	2015	6	6
OVERSTATED ASSETS	2013	8	18
	2014	8	10
	2015	10	26
UNDERSTATED EXPENSES	2013	3	5
	2014	4	5
	2015	4	14
MISUSE OF CORPORATE ASSETS	2013	13	26
	2014	9	18
	2015	16	22
CONTROLS	2013	5	7
	2014	2	2
	2015	0	0
DISCLOSURES	2013	7	24
	2014	9	17
	2015	6	24
AUDITING STANDARDS	2013	6	12
	2014	7	14
	2015	8	12
AUDITOR INDEPENDENCE	2013	13	14
	2014		
	2015	2	2
OTHER	2013	6	8
	2014	2	2
	2015	4	6

The SEC's 2014 and early 2015 cases follow the trends predicted in last year's report. For example, revenue recognition has indeed remained "a staple of [the] financial fraud caseload."[8]

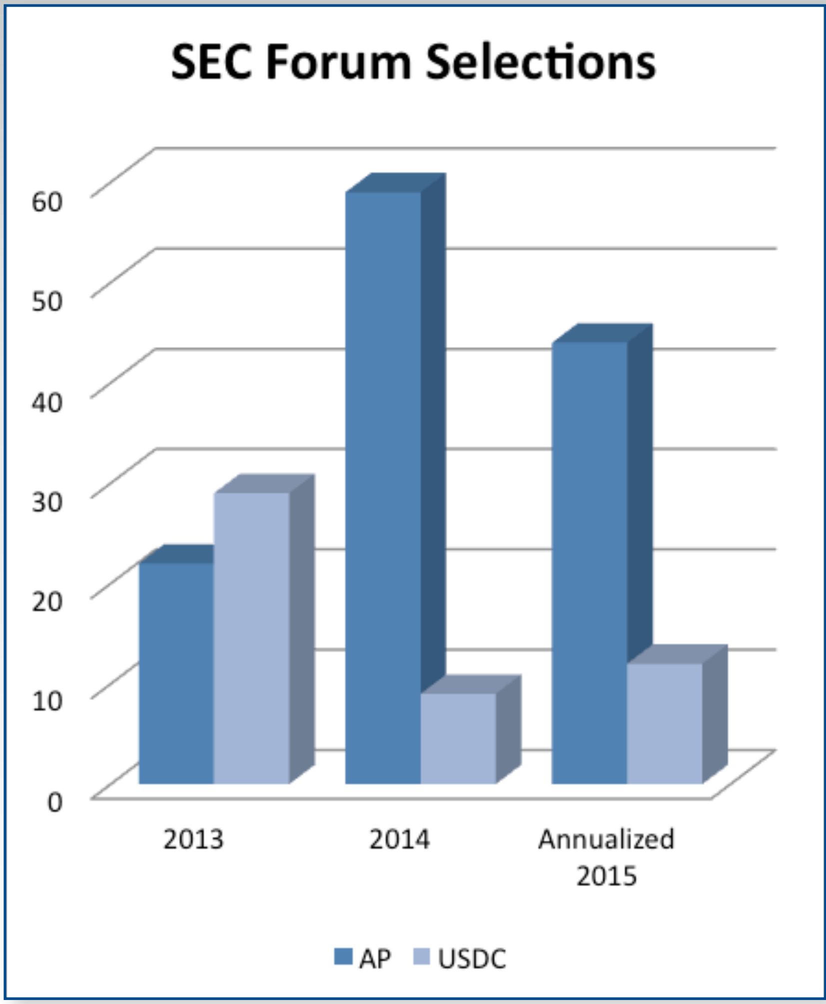
And the SEC has, in fact, focused on other manipulations of performance and balance sheet metrics, as well as misuses of corporate assets.[9]

Moreover, the 2014 cases reflect close scrutiny of auditing standards and independence, which is not surprising given the uptick in number of cases against audit firms. The first half of 2015, on the other hand, reflects more attention to alleged accounting manipulations, other disclosure issues, and misuses of corporate assets. More on these topics below.

FORUMS AND VENUES

Much has been written about the SEC's increasingly-frequent choice to file its enforcement cases as administrative proceedings (APs), as opposed to filing in U.S. District Court, and the ramifications of this choice for defendants.[10] Indeed, this trend is easily one of the most significant SEC enforcement developments over the past 18 months.

An uptick in APs certainly occurred with the SEC's financial reporting and auditing cases. Of the new cases filed in 2014, the SEC initiated 59 APs involving 89 respondents, versus filing 8 cases in the federal courts against 24 defendants.[11] The SEC's forum selections during the first half of 2015 appear to continue this trend. These choices differ dramatically from the SEC's forum selections during calendar year 2013, as illustrated below.

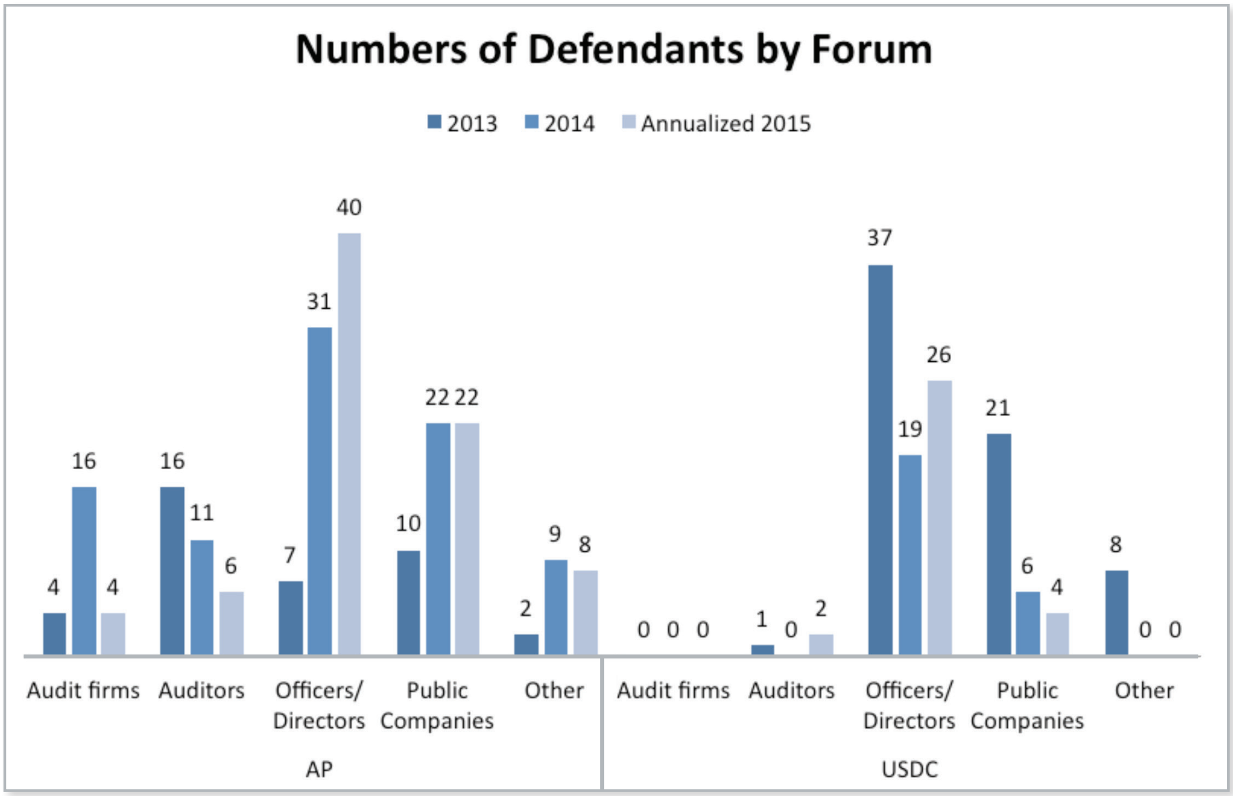


Moreover, the SEC has increasingly chosen to file APs against entities and individuals that it historically sued in federal courts. The SEC filed most of its 2013 financial reporting cases against public companies and their personnel in federal courts.[12] The pattern over the past 18 months, however, is quite distinct. The number of officers/directors and public companies named in APs increased significantly in 2014 and annualized 2015, coupled with a corresponding decrease in federal court actions.

This also comes as no great surprise. As reported last year, David Woodcock – chair of the Task Force until recently – stated that he was a "big proponent" of bringing financial reporting cases as APs, and that he anticipated shifting more towards the AP forum.[13] Director Ceresney likewise frequently has advocated the SEC's increased use of APs.

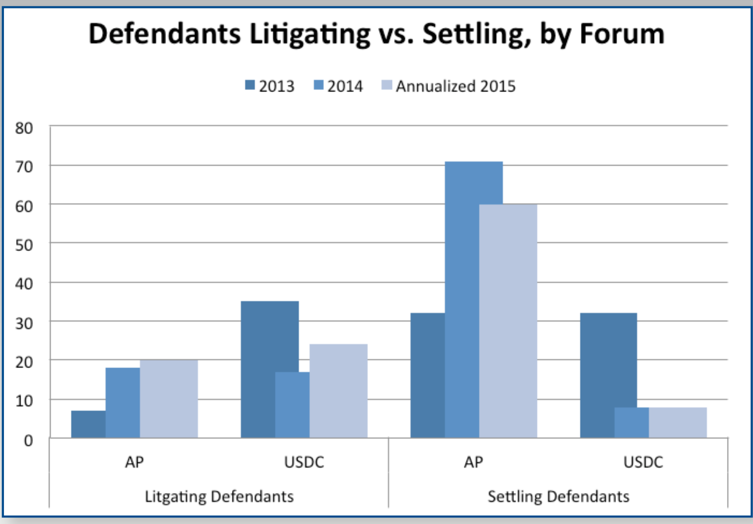
A constant in the SEC's financial reporting and auditing case filings is the truly national reach of its enforcement program. In 2014 and early 2015, the SEC filed financial reporting and auditing cases in federal courts located in New York, D.C., Rhode Island, Wisconsin, Tennessee, California, Indiana, Illinois, Delaware, and Texas.

Like in 2013, the SEC filed its largest federal court case of 2014 – in terms of number of defendants – in middle America. In the 2014 case, filed in the Middle District of Tennessee, the SEC sued an issuer, four of its executives, and two of its directors based on an investigation conducted by the agency's Denver Regional Office. The complaint alleged that the animal feed company and its personnel made numerous false statements about its sales of feed and purported sales of hogs in China in order to falsely inflate revenues and prop up the company's stock price. According to the SEC, the hogs did not exist and the company's true (hidden) revenues were much lower than the reported amounts.[14] Some defendants settled the case upon filing, while some continue to litigate.



LITIGATE OR SETTLE?

As in years past, the majority of defendants settled the SEC's charges at the time of filing. In 2014, over two-thirds of defendants (69%) settled their charges at filing. The first half of 2015 is trending towards an annualized total of defendants settling upon filing that is similar to 2013 (approximately 60%). The chart below illustrates the number of defendants choosing to litigate or settle their matters at initiation, by forum.



Although the overall number of litigating versus settling defendants remains relatively consistent, more defendants are litigating their APs. Only 7% of respondents litigated their APs in 2013 (and 30% settled). Yet approximately 16% of respondents chose to litigate their APs in 2014 (with 62% settling), and the number of respondents choosing to litigate APs in 2015 is trending towards 18% (and towards 54% settling).

In contrast, 33% of defendants initially chose to litigate in federal court in 2013 (and 30% settled), as compared to 15% of defendants litigating in 2014 (with 7% settling), and a trend towards 21% of defendants litigating in 2015 (and towards 7% settling).

Perhaps this upward litigation trend is due to the sheer volume of APs that the SEC initiated in this area over the past 18 months. Or maybe recent criticism of the SEC's APs and defendants constitutional challenges emboldened potential litigants. Nevertheless, the AP remains a daunting venue for the potential litigant.[15] At bottom, deciding to litigate or settle claims is a highly case-and-defendant-specific decision to be carefully considered.

SEVERE SANCTIONS

The SEC's financial reporting and auditing settlements in 2014 and early 2015 involved not only pricey monetary penalties, but also costly non-monetary sanctions such as undertakings and professional bars.

(A) EYE-POPPING CIVIL PENALTIES

The matters that resolved in 2014 and the first half of 2015, resulted in the approximate average civil penaltieslisted below.[16]

	2014	FIRST HALF 2015
OVERALL	$558,060[17]	$5,065,770[18]
INTERNATIONAL DEFENDANTS ONLY	$640,176	$9,111,111
AUDIT FIRMS	$177,219[19]	$337,500
AUDITORS	$7,000	$33,000
OFFICERS/DIRECTORS	$98,000	$72,167
PUBLIC COMPANIES	$2,028,212[20]	$21,434,856[21]
OTHER	$214,286	None
FRAUD	$863,386[22]	$11,967,188[23]
NON-FRAUD	$461,600[24]	$2,305,203[25]

These averages are overshadowed by five eye-popping civil penalties announced in 2014 and early 2015. Most recently – and significantly – an international information technology company settled with the SEC in June 2015, agreeing to pay a $190 million civil penalty and to certain undertakings.[26] The case, described in more detail below (see Topic (2) in "Forewarned is Forearmed"), involved multiple instances of alleged accounting and disclosure misconduct in divisions around the world. Astoundingly, the SEC states that it considered the company's remedial acts and cooperation when reaching this settlement.

This nine-figure civil penalty, however, is an outlier even among the four other outliers, which each involved eight-figure civil penalties. In May 2015, a Germany-based bank agreed to pay a $55 million civil penalty to settle SEC claims about Financial Crisis-related conduct.[27] Also in May 2015, a UK and Australia-based company settled FCPA-related charges, agreeing to pay a $25 million civil penalty.[28] In this latter case, also discussed in more detail below, the SEC again claimed that its settlement recognizes the company's cooperation and remedial efforts. In August 2014, a US-based bank agreed to settle claims about Financial Crisis-related conduct by making certain admissions, and paying a $20 million civil penalty.[29] And in April 2014, a retail drug store chain company agreed to pay a $20 million civil penalty when settling SEC charges relating to alleged accounting manipulations.[30]

For those keeping count, these five outlier settlements – some recognizing the company's cooperation and remedial efforts! – yielded a grand total of $310 million in civil penalties for the SEC. In other words, the civil penalties collected from these five companies alone would cover almost 60% of the amount that the SEC sought for its entire enforcement program in its FY2016 budget request, and would cover 18% of the SEC's overall $1.722 billion FY2016 budget request.[31]

(B) ONEROUS UNDERTAKINGS & BARS

Settlements in financial reporting and auditing cases have included undertakings. These sanctions impose significant costs on the companies and individuals involved. In one case, for example, the SEC charged a jewelry and collectables company with reporting, recordkeeping, and controls violations related to accounting manipulations made by an executive.[32] In its settlement with the SEC, the company agreed to engage a national consulting firm to identify errors in "electronic accounting system functioning, reconcile prior inventory discrepancies, and balance the general ledger to the physical inventory counts," as well as to implement other prospective remedial measures.[33] Such far-reaching ongoing obligations do not come cheap.

Historically, the SEC has employed corporate undertakings when settling FCPA matters, and certain other case types. By imposing undertakings in financial reporting and auditing cases as well, the SEC is demonstrating that it will consider such measures in all matter types.

The SEC additionally continues to seek bars against individual defendants – sanctions that have significant ramifications for individuals and their families. The SEC has sought bars prohibiting individual defendants from serving as an officer or director of a public company (an "O&D bar") or from practicing before the Commission (a "102(e) bar"). True to historical trends, O&D bars during 2014 and the first-half of 2015 ranged from five years to permanent. The SEC also sought 102(e) bars against individual accountants that ranged from issuance of a suspension to permanent.

Ten significant trends emerge from the SEC's 2014 and early 2015 cases, public comments, and other developments about financial reporting and auditing matters.

(1) AUDITORS/AUDIT FIRMS ARE FRONT AND CENTER

2014 may well be remembered as the "Year of the Auditor" when looking back at SEC financial reporting and auditing enforcement trends. As shown in the above "Crunching the Numbers" section, the number and percentage of auditor and audit firm defendants increased by a sizable amount in 2014 as compared to 2013. Moreover, the SEC brought multiple headline "message" cases in 2014 and the first half of 2015 against auditors and audit firms. Although the volume of cases against auditors and audit firms leveled off in the first half of 2015, the SEC's intense focus on auditors and audit firms shows no signs of abating any time soon. Indeed, according to Director Ceresney, additional significant cases against audit firms and auditors are in the works.[34]

> **2014** may well be remembered as the **"Year of the Auditor"...**

The SEC's auditing enforcement cases centered around two primary themes: (A) protecting the integrity of auditors' role as independent gatekeepers, and (B) sanctioning allegedly deficient auditor performance.

(A) Auditors as Independent Gatekeepers

In 2014 and the first half of 2015, the SEC filed fourteen cases against fifteen defendants focused on auditor independence issues. These cases, in the words of one SEC official, punctuate that "[a]uditors must vigilantly safeguard their independence…."[35]

For example, the SEC alleged that a division of a Big Four firm provided legislative advisory services to some of the firm's audit clients in violation of independence standards.[36] The firm settled, agreeing to disgorge $1.24 million plus interest and to pay a civil penalty of $2.48 million. The SEC announced that its sanctions incorporated consideration of the firm's remedial acts and cooperation.

The SEC alleged that a different Big Four firm likewise provided prohibited non-audit services to its public company clients, which here included corporate finance, restructuring, bookkeeping, and payroll services.[37] Moreover, the SEC alleged that the firm hired a former employee of a client, then loaned the individual back to perform the same job. The firm settled, agreeing to make changes to its internal processes, hire an independent consultant to review and evaluate the changes, and pay approximately $6.5 million in disgorgement and interest as well as a $1.775 million civil penalty.

At the same time as this case, the SEC issued a Report of Investigation under Section 21(a) of the Exchange Act.[38] These reports, which the Commission issues when it determines not to pursue an enforcement action on a certain matter but nonetheless believes that the matter warrants a public discussion, are not common – it has issued only 14 since 1996.[39] The 21(a) Report here focused on the practice of loaning non-manager-level tax professionals to audit clients, and the risk that these arrangements could violate Rule 2-01 of Regulation S-X.

The 21(a) Report underscores the SEC's view of the importance of auditor independence, and its continued close scrutiny of independence issues going forward. In fact, on July 1, 2015, the SEC sanctioned a Big Four firm for independence violations because an affiliate of the firm acquired a proprietary methodology from an individual serving on the boards of trustees and audit committees of three audit clients.[40] The firm discovered the issue itself, investigated the matter, reported to other involved entities and to the SEC, and implemented additional remedial steps to improve its independence policies and procedures going forward. The SEC announced that it considered these steps when determining sanctions. The firm settled the SEC's charges, agreeing to pay over $600,000 in disgorgement and interest and a civil penalty of $500,000.

The SEC examined independence issues among firms of all types and sizes. In December 2014, for example, the SEC announced settlements with eight non-Big Four firms for allegedly violating auditor independence rules by helping their broker-dealer audit clients to prepare their financial statements and notes.[41] Separately, in September 2014, the SEC filed a litigated AP against a non-Big Four audit firm that maintained a staffing and revenue sharing arrangement with a public company, while a different broker-dealer audit client owned that company's stock.[42]

And the SEC has not focused solely on firms. The SEC imposed a two-year bar on a retired Chief Risk Officer of a Big Four firm, for example, due to his alleged acceptance of casino credits from a gaming company audit client.[43]

Nor will the SEC ignore other matters that it believes may erode auditors' role as independent gatekeepers. A Florida-based audit firm and auditor, for example, settled charges alleging that the firm's owner continued to conduct and direct an audit, even though the owner was required to rotate off of the engagement, by appointing a nominal lead partner who was not a CPA.[44] Considering respondents' remedial efforts, the SEC settled with a one-year bar against the owner and a civil penalty of $15,000 assessed jointly and severally against both respondents. The SEC also filed a litigated action in federal court against an accountant who served as a financial consultant for a public company, allegedly in violation of a prior Commission order suspending the defendant from practice.[45]

> **"[i]ndependence** is an issue that we are very focused on, and **will continue to stay focused on."**

The SEC's focus on auditor independence shows no signs of relenting. According to one press report, the SEC's chief accountant recently proclaimed that "[i]ndependence is an issue that we are very focused on, and will continue to stay focused on."[46] Indeed, the SEC receives hundreds of auditor-independence questions a year – approximately one per day.[47] Auditors and audit committees thus should maintain constant vigilance for potential independence concerns.

(B) Audit Performance Issues

The SEC filed eleven cases involving twenty defendants during 2014 and the first half of 2015 that focused on audit quality issues. Many of these cases appear to involve extreme facts raising multiple alleged deficiencies in auditor performance. For example, the SEC alleged that charged auditors:

- Failed to conduct sufficient audit testing, instead accepting management's representations, particularly with respect to areas determined to raise fraud risks, in violation of AU §§ 230, 316, 326, and/or 333.[48]
- Failed to properly document audit procedures and the evidentiary basis for the auditor's conclusions, in violation of AU § 326 and/or AS No. 3.[49]
- Failed to consult with prior auditors, in violation of AU § 315.[50]
- Relied on unqualified staff for, or failed to sufficiently supervise audit procedures, in violation of AU §§ 210, 230, 311, and/or AS No. 10.[51]
- Failed to obtain engagement quality reviews in violation of AS No. 7.[52]
- Failed to preform appropriate procedures to ascertain the occurrence of subsequent events, in violation of AU §§ 560 and/or 561.[53]
- Failed to sufficiently assess or audit specific substantive areas, such as related-party transactions (AU § 334), internal controls (AU § 319), accounts receivables (AS 3.6 / AU § 330), and inventories (AU § 331).[54]
- Failed to appropriately audit a broker-dealer's financials, which led to inflated securities positions and understated liabilities, which resulted in overstatement of the firm's reported net capital.[55]
- Failed to conduct surprise audits for an investment adviser client, in violation of the Custody Rule.[56]

Auditors and audit firms should assume that the SEC will examine audit and review work in every matter raising financial reporting concerns, looking through an enforcement lens and aided by hindsight and new information.

(2) INDIVIDUALS IN THE CROSSHAIRS

The SEC historically has targeted individuals in financial reporting and auditing matters, and 2014 and the first half of 2015 were no exception. Indeed, 2015 so far has trended towards a significant uptick in enforcement against individuals – particularly against corporate personnel. In other words, if 2014 was the "Year of the Auditor," then 2015 is trending towards being the "Year of the Officers and Directors."[57]

Over the past 18 months, the SEC sued almost 100 individuals for financial reporting and auditing matters – 82 of whom were public company officers or directors. Not surprisingly, CEOs, CFOs, controllers, and other finance professionals constitute most of these defendants. Yet the SEC also will not hesitate to pursue other employees who it believes were involved in the challenged issues.

Nor will the SEC shy from employing its full arsenal of sanctions against individuals, including disgorgement, civil penalties, and O & D bars. According to the *Wall Street Journal*, the civil penalties levied by the SEC against individuals more than doubled over the past decade.[58] The SEC appears to have made good on Chair White's pledge to make "aggressive use" of civil penalties, at least with respect to individual defendants.

A June 2015 case involving an international information technology company illustrates the SEC's vigorous enforcement against individuals.[59] The SEC alleged that the company made misstatements about difficulties that it had with a large contract with the United Kingdom's National Health Service, as well as misstated its financial results due to multiple accounting manipulations occurring in divisions throughout the world. The company itself settled the SEC claims, agreeing to pay a hefty $190 million civil penalty and to retain an independent consultant to review the company's ethics and compliance program. The SEC also filed against the company's CEO/Chairman, its CFO, the Australian CFO, the Finance Director of the Nordic Region, two Finance Managers for the Nordic Region, a Finance Director for the NHS account, and the Australian controller. All but three individuals settled with the SEC at the time of filing. The SEC racked up over $900,000 in additional civil penalties, disgorgement, and prejudgment interest against these settling individuals.

Additionally, in appropriate cases, the SEC will pursue clawbacks under Sarbanes-Oxley Act Section 304, which requires the CEO and CFO to repay their bonuses or incentive-based compensation to the issuer if it restates its financials due to misconduct. In the above case against the international information technology company, for example, the SEC clawed-back over $4 million from the CEO and CFO under Section 304.

In fact, the SEC utilized Section 304 several times during 2014 and early 2015. Two instances are noteworthy because the executives were not alleged to have participated in the wrongdoing. In September 2014, the SEC obtained a $2.5 million clawback from the former CEO of a software company that allegedly misstated its revenues, even though the CEO was not personally accused of any misconduct.[60] Similarly, in November 2014, the SEC obtained a clawback of $106,250 – as well as 59,738 shares of the company's stock – from the former Chairman / CEO of a jewelry company that allegedly overstated its inventory, even though the SEC did not allege that the executive participated in the wrongful conduct.[61]

Clawbacks under such circumstances are not common, although we may be witnessing the leading cusp of increasingly frequent use. (See the SEC's new initiative in this area, discussed below in Topic (10).) Simply put, companies and executives should assume that the SEC will carefully scrutinize potential incentives for financial reporting fraud, and will pursue clawbacks when it believes that doing so will enhance accountability.

Moreover, the SEC will – in the words of Director Ceresney – "aggressively pursue individual responsibility while rewarding extraordinary cooperation and remediation by companies."[62] In one case, for example, the SEC asserted fraud charges against three former senior managers of a bank for allegedly misclassifying impaired loans.[63] The SEC also entered into a deferred prosecution agreement with the bank itself, crediting the bank's extensive remedial efforts and cooperation with the SEC's investigation. Individuals embroiled in SEC investigations thus are well-advised to consult with their own SEC defense counsel, independent from company counsel, to best protect their individual interests.

(3) SEC STILL FOCUSED ON THE "NUMBERS GAME"[64]

Over half of the SEC's financial reporting and auditing cases in 2014 and early 2015 involved alleged accounting manipulations designed to make the reported financial results appear better than they actually were. These cases generally fall into four categories.

(A) Revenue Recognition

It should come as little surprise that the SEC continues to carefully scrutinize revenue recognition.

In most cases filed in 2014 and early 2015, the SEC essentially alleged that defendants engaged in fiction writing – claiming that the recorded revenues were entirely fabricated. For example:

- The SEC sued a China-based company and multiple its officers and directors for recording revenues for false sales of livestock and feed.65 One officer settled, agreeing to pay a $100,000 civil penalty, while the company and other officers initially chose to litigate.
- The SEC sued two individuals associated with a company that ran assisted living facilities for allegedly recording revenues supposedly based on individuals who did not actually live at the facilities.66 Both chose to litigate the SEC's case.
- The SEC sued a software company and three officers for allegedly inflated professional services revenues due to, among other things, falsified time records.67 The defendants settled, with the company agreeing to pay a $1.75 million civil penalty; two officers agreeing to pay more than $50,000 in disgorgement and interest, and a $50,000 civil penalty each; and the third officer (the former CEO) agreeing to pay over $2.5 million as a clawback.
- The SEC sued two officers for allegedly arranging for an equipment manufacturer to redirect preexisting orders through the company, and recognizing revenues on the sales despite playing no substantive role in the transaction.68 Both settled, agreeing to pay more than $500,000 combined in disgorgement and interest, as well as a $52,000 civil penalty each.

In other matters filed in 2014 and early 2015, the SEC challenged the timing of revenue recognition. For example, a public company and one of its officers / directors settled the SEC's claims that the company prematurely recognized revenues on sales before all of the revenue recognition criteria were met.[69] Recognizing the company's own remedial action for the issue, the SEC agreed to a settlement requiring the company to pay a $500,000 civil penalty and the officer to pay a $50,000 civil penalty. In a second case, a public company settled the SEC's claims that the company prematurely recognized revenue from software license sales without establishing vendor specific objective evidence of fair value.[70] The company agreed to pay a $750,000 civil penalty. And in a third case, a company and two of its officers litigated the SEC's claims that the defendants improperly recognized revenues for sales subject to unsatisfied conditions.[71]

The new revenue recognition standards announced by the Financial Accounting Standards Board in May 2104 may spur additional SEC enforcement.[72] This new standard abandons a proliferation of specific requirements, instead embracing a principled approach that requires judgments and estimates in its application. Controls and disclosures likewise may require revamping due to the new standards. Consistent and smooth implementation is a priority for the SEC, and the Enforcement Division will be carefully monitoring for potential abuses.[73]

(B) Understated Expenses

The SEC continues to frown on misstated performance, no matter where the allegedly manipulated line item appears in the financials.

In January 2014, for example, the SEC filed against a snack food company, and its former CEO and CFO, for allegedly improving the company's publicly reported performance by underreporting money paid to walnut growers.[74] The company and CEO settled, with the former agreeing to pay a $5 million civil penalty and the latter agreeing to pay a $125,000 civil penalty (the SEC's order also noted that the CEO had already returned or forfeited over $4 million in bonuses and other compensation).

In another case, the SEC charged a public bank holding company for allegedly understating its loan loss provision for matured and past due loans by approximately $13 million.[75] The company settled the case, agreeing to disgorge $16 million and pay over $2.5 million in interest.

(C) Reserves and Accruals

The SEC has long targeted defendants that engage in abuses such as "cookie jar" reserves, and it likely will bring more cases sanctioning such practices in the future.

For example, the SEC recently settled with a technology company and five of its officers for allegedly engaging in a far-reaching accounting and disclosure fraud.[76] Among other things, the SEC alleged that executives located in Australia manipulated the company's results by maintaining excess unsupportable accruals associated with gift cards given to employees, which accruals they later released to boost earnings.

(D) Overstated Assets

As with each of the above SEC focus areas, companies, their personnel, and their auditors should pay close attention to all aspects of their reported financials to ensure that they accurately reflect the company's current financial condition.

For instance, the SEC charged a jewelry company and its CFO for allegedly inflating the value of inventory by 99% to 227% by making it appear that the company owned inventory that actually belonged to customers in consignment arrangements.[77] Both defendants settled, with the CFO agreeing to pay a $75,000 civil penalty and the company agreeing to appoint an independent consultant to review the company's accounting controls.

In another case involving inventory, the SEC settled with a former vice president of finance who worked at a wholly-owned private subsidiary of a public company.[78] According to the SEC, both before and after the public company acquired the private subsidiary, the defendant manipulated inventory counts to boost profit margins. Inaccurate financial data thus was reported in the parent company's financial statements, although the SEC's order acknowledges that the company concluded the improper adjustments were not material in any one reporting period and would not result in a restatement (it recorded a one-time non-cash charge). The individual agreed to pay a $25,000 civil penalty.

And the SEC extracted a $20 million civil penalty from a retail drug store chain company, as well as additional sanctions against a former retail controller, for an alleged change in accounting treatment that significantly altered the company's reported results, among other issues.[79] The SEC alleged that the controller improperly wrote-down the value of personal property, which he then partly reversed thus enabling the company to exceed EPS projections for that quarter. The SEC claims that the asset write-down should have been treated as a current-period expense and, thus, the affected quarter's EPS would have reduced by 17%. In addition to the eye-popping civil penalty to which the company agreed, the controller agreed to pay a $75,000 civil penalty.

Moreover, cases announced in April 2015 provided important reminders that accurate accounting is not just for public companies. The SEC announced three separate settled APs initiated against the owner/CEO, a controller, and a vice president of sales of private companies.[80] The respondents allegedly overstated the value of the private companies' assets – inflating inventory values and prematurely recognizing revenues – in order to fraudulently inflate the acquisition price paid by a public company. The respondents allegedly thereafter concealed that fact from the public company by prematurely recognizing revenues after the asset purchase, which resulted in misstatements in the public company's filings. The defendants all settled, collectively agreeing to approximately $600,000 in disgorgement, interest, and civil penalties. The owner/CEO also agreed to a ten year O&D bar.

(4) BUT IT'S NOT JUST ABOUT THE NUMBERS

A significant number of the SEC's cases in 2014 and early 2015 involved allegedly inaccurate disclosure issues other than accounting manipulations.

Some cases involved alleged misstatements about companies' business operations. In June 2015, for example, the SEC alleged that an international information technology company made misstatements about its performance of a significant contract with the United Kingdom's National Health Service.[81] Among other things, a defendant allegedly misstated that the company was meeting its performance obligations on time, and without incident, when in fact there were concerns and extensions. This case was also noteworthy, as discussed above, because of the number of individuals sued and the nine-figure civil penalty levied against the company. Similarly, in August 2014, the SEC alleged that an oil and gas exploration and production company, and its CEO, publicized exaggerated estimates of the company's oil reserves that lacked a reasonable basis and that were falsely attributed to a third-party.[82] The defendants litigated the SEC's charges.

The SEC also charged alleged misstatements about the role played by certain personnel. In March 2014, for example, the SEC filed a litigated action against a coal company headquartered in Seattle (with operations in China and Taiwan) and various executives for allegedly misstating that certain individuals served as CEO and CFO when, in fact, the Chairman of the Board ran the company.[83]

> **...accurate** accounting is not just for **public companies.**

Similarly, in February 2015, the SEC filed a litigated action against a government contractor firm and two individuals for allegedly working with an accountant subject to a PCAOB bar and falsely certifying the evaluation of internal controls that allegedly did not occur.[84]

In other cases, the SEC focused on alleged misstatements occurring during corporate acquisitions. For example, the SEC settled with a Canadian entertainment company in March 2014 for engaging in a series of transactions that put stock in the hands of a management-friendly director, allegedly to defeat a hostile tender offer without disclosing as much.[85] The company admitted wrongdoing and agreed to pay a $7.5 million civil penalty. In another matter announced in September 2014, the SEC filed litigated charges against a China-based company and multiple individuals for alleged misstatements about a 2010 acquisition of another company in an effort to mask the acquired company's prior FCPA violations.[86]

Furthermore, the SEC charged numerous individuals and entities for reporting violations concerning individual stock holdings and transactions.[87] These coordinated actions against dozens of defendants illustrate the SEC's "broken windows" approach to enforcement – that no violation is too small for the SEC "cop on the beat" to pursue.

The SEC's enforcement energies are not solely directed towards accounting and auditing concerns alone. Entities and individuals should take equal care when making qualitative public statements about the business.

(5) CONTROLS ARE CRITICAL

From the SEC's perspective, a weak internal control environment increases the likelihood that a violation may occur. Predictably, the SEC staff has oft proclaimed that the effectiveness of internal controls is an important issue and an ongoing area of focus.[88] One SEC staffer, for example, explained that he "continue[s] to question whether material weaknesses are being properly identified, evaluated, and disclosed" and that "efforts throughout the SEC pertaining to the [controls] requirements are ongoing, coordinated, and increasingly integrated into our routine consultation, disclosure review, and enforcement efforts."[89]

> The **SEC's** clear message with this controls case can be summarized in three words: **"best, better, bad."**

Many of the cases discussed in this review also involved allegedly deficient internal controls. Two recent cases highlight key aspects of the SEC's perspectives on internal controls.

First, in a May 2014 settlement with a jewelry company, the SEC claimed that the CFO (who was also charged) "…took advantage of [the company's] weak internal control environment to intentionally manipulate" inventory valuations.[90] The SEC's complaint alleges that the company lacked sufficient written policies, staffing in the accounting department, and it failed to follow accounting best practices. According to the SEC, the company conducted an internal investigation that likewise identified a number of controls and systems deficiencies, including unsupported and improperly described entries, insufficient processes and systems, a lack of proper audit trail, and insufficient data security.[91]

The company settled to reporting, recordkeeping, and internal controls failures only – not fraud. In apparent recognition of the company's remedial efforts – which included personnel changes, new policies and procedures, and hiring an independent consultant – the SEC did not impose a civil penalty on the company in the settlement.

The SEC's clear message with this controls case can be summarized in three words: "best, better, bad." That is, with this and other cases, the SEC communicates that robust internal controls *best* help companies avoid issues in the first instance, and the SEC will pursue companies with deficient controls.[92] Yet this case and others also tell a "*better* late than never" story – although the company here allegedly did lack sufficient preemptive controls safeguards, the company's prompt self-identification, investigation, and remediation still yielded benefits when settling with the SEC.[93] And taking these steps helped the company avoid a "*bad*" result.

At least one study, however, might dilute the SEC's "better" message. It concluded, "not only do companies that give advance warning of internal-control problems gain nothing by their transparency but they are actually penalized compared to firms that divulge such problems only when forced to restate their finances – too late to be of help to investors."[94] This study certainly should not guide conduct or disclosures – withholding negative controls information or failing to conduct a proper analysis could subject individuals and entities to liability. Yet it may provide insights to the SEC when determining sanctions in particular cases.

Second, in July 2014, the SEC announced two related APs against former executives of a company that resold and provided maintenance services for used computer equipment.[95] The SEC alleged that the executives certified, in the company's annual filing, that they evaluated the company's internal controls and had disclosed all significant controls deficiencies to the external auditors. In truth, according to the SEC, the executives did not participate in the controls assessment process and they affirmatively misled the external auditors about the sufficiency of controls. The SEC alleged that problems in the company's controls led to misstated inventory and accounts receivables.

One executive (former CFO) settled with the SEC, agreeing to pay a $23,000 civil penalty and to a five-year bar from serving as an officer, director, or practicing public accounting. The other executive (former CEO and Chairman of the Board) litigated the SEC's charges.

The SEC's message with these latter cases is akin to its message to all types of gatekeepers: The SEC will not only pursue alleged wrongdoers, but also those standing guard who the SEC believes could have prevented the fraud with more diligence. Or, in the words of Chair White, compliance (and controls) must "become the zeitgeist of the institution."[96]

(6) WATCH FOR MISUSES OF CORPORATE FUNDS

In 2014 and early 2015, the SEC filed 17 cases against 29 defendants alleging misuses of corporate assets. These cases fall into three categories.

First, twelve cases involved thirteen defendants' alleged violations of the Foreign Corrupt Practices Act (FCPA). Although each of these cases involved their own circumstances, they generally all lead to the same takeaways:

- Companies both large and small that do business abroad cannot ignore the FCPA;
- Using third-party consultants or agents increases the risks of a FCPA violation;
- Payments that violate the FCPA can take many forms, and companies must be vigilant in their efforts to avoid infractions;
- Policies, training, and controls focused on FCPA risks provide critical safeguards against potential FCPA violations;
- Many FCPA actions involve parallel DOJ and SEC proceedings;
- Self-discovery, investigation, and remediation may yield benefits, such as a reduced civil penalty;
- Even in a favorable settlement, the monetary costs of a FCPA violation, including disgorgement and civil penalties, can be staggering; and
- Given the proliferation of risks, however, companies are well advised to explore efficient and cost-effective investigation of potential issues by counsel, in lieu of employing a scorched-earth approach every time something is reported internally.

One recent case, involving settled FCPA allegations against a global resources company based abroad, with U.S.-traded American Depository Shares, warrants discussion.[97] The company allegedly sponsored a hospitality program at the Beijing Summer Olympics that included foreign government officials, some of whom were in a position to influence business and regulatory matters involving the company. Recognizing the company's internal investigation and cooperation, the SEC charged books and records and internal controls violations, which the company settled and agreed to pay a $25 million civil penalty.

Importantly, the company did have at least some internal controls over the program, including a questionnaire form intended to identify potential FCPA risks. Yet the SEC levied multiple criticisms against the form's sufficiency and the company's compliance follow-up to the answers provided. Moreover, the SEC expansively based its books and records charge on alleged misstatements in the hospitality forms, rather than more narrowly focusing on documents directly tying to the financial statements. This case thus provides a cautionary tale – the SEC expects much from companies in terms of internal compliance, and the SEC will not shy from aggressively and expansively using non-fraud charges to sanction ineffectual efforts.

Second, four cases involved fourteen defendants' alleged violations stemming from undisclosed related party transactions and executive compensation issues. These cases follow two familiar themes:

- Entities should fully identify and appropriately disclose related party transactions, and the SEC will sanction companies – as well as individuals – who do not vigilantly undertake this task; and
- Companies should ensure that their controls include careful scrutiny of executive submissions for reimbursement of supposed business expenses, lest the amounts actually constitute undisclosed personal perquisites.

Indeed, these matters remain in the spotlight due to the PCAOB's adoption of Auditing Standard (AS) No. 18.[98] This standard requires auditors to heighten their scrutiny of a company's related-party transactions, significant unusual transactions, and financial relationships and transactions with executives (including compensation agreements). AS No. 18 extolls auditors to probe the business purpose for and context surrounding these matters, and to make specific inquiries of the audit committee or its chair about the committee's understanding of such transactions.

Third, one case involving two defendants falls into its own category. In this case, the SEC alleged that a senior accounting officer of a Japanese subsidiary of a Chicago-area company lost over $110 million when he engaged in unauthorized equity trading in the company's brokerage accounts.[99] The executive apparently concealed the losses by borrowing from Japanese banks – in the company's name – and using the proceeds to replenish the brokerage accounts. Shockingly, the executive's scheme apparently began in the late 1980s, and continued undetected until the company restated its financials in early 2010. The company was forced to recognize over $200 million in cumulative net losses due to trading losses and borrowing costs. This case provides a stark example of the importance of robust internal controls, as well as periodic validation of their effectiveness.

Put simply, the SEC expects entities and individuals to use corporate assets to benefit shareholders, not to misuse those assets to line foreign officials', executives', or related-parties' pockets.

(7) WHISTLEBLOWERS REWARDED

The SEC's whistleblower program continued to make headlines in 2014 and early 2015. Under this program, established with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), whistleblowers who provide information that leads to a successful enforcement action involving sanctions of over $1 million may receive an award of 10% to 30% of the amount collected by the SEC.

The number of whistleblower tips received by the SEC's Office of the Whistleblower continues to rise. In fiscal year 2014, the office received 3,620 tips, up from 3,238 tips in fiscal year 2013.[100] Notably, these tips most commonly raised concerns about "Corporate Disclosures and Financials," (aside from tips classified as "other"), thus stoking SEC suspicion about a profusion of financial reporting and auditing issues for potential enforcement.

Notably, these tips most commonly raised concerns about "Corporate Disclosures and Financials"...thus stoking **SEC** suspicion about a profusion of financial reporting and auditing issues for **potential enforcement.**

The SEC also publicly touts that it "continue[s] to receive higher quality tips that are of tremendous help to the Commission in stopping ongoing and imminent fraud, and lead to significant enforcement actions on a much faster timetable than we would be able to achieve without the information and assistance from the whistleblower."[101] The data may back this bravado. According to one academic study, "[u]sing a dataset of employee whistleblowing allegations obtained from the U.S. government and all enforcement actions for financial misrepresentation, we find whistleblower involvement accounts for 30% of $70.13 billion in total penalties assessed and more than doubles prison sentences against individuals."[102]

The whistleblower program achieved several milestones in 2014 and early 2015. It issued more awards to individuals than in all prior years combined.[103] And on September 22, 2014, the SEC announced its largest single award to an individual to date: $30 million.[104] This award more than doubled the pre-existing largest award of $14 million.

Additionally, the SEC took steps to protect the opportunity for whistleblowers to submit tips. The SEC sanctioned a company for allegedly using confidentiality agreements to stifle whistleblower reports.[105] And the SEC announced its first award to a whistleblower in a retaliation case.[106]

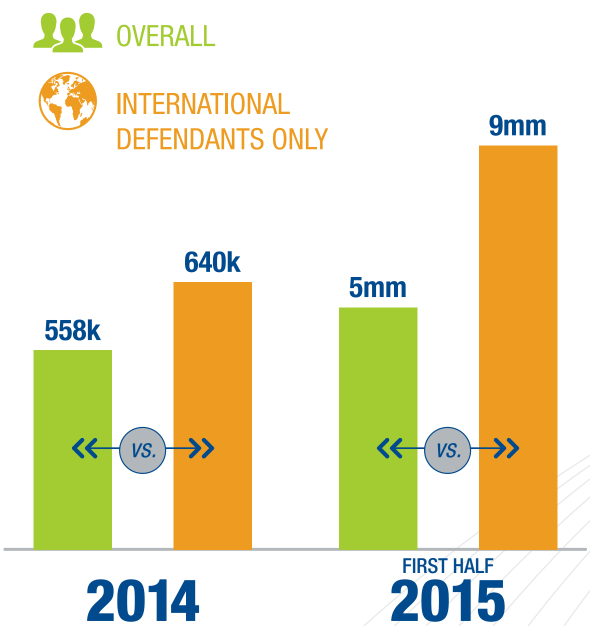
The SEC also issued an award to an individual who reported to the SEC after the company failed to address the issue internally, and awards to several individuals serving in compliance and audit functions.[107] Each of these announcements provide important reminders that companies should appropriately and promptly address reports of potential wrongdoing. Or, in Chair White's words, these and other whistleblower awards have "created a powerful incentive for companies to self-report wrongdoing to the SEC – companies now know that if they do not, we may hear about the conduct from someone else."[108]

At bottom, the SEC continues to promote its whistleblower program as an effective, and important, instrument in its enforcement toolbox. The program likely will continue to play a prominent role in financial reporting and auditing cases going forward.

(8) SEC CONTINUES TO GO GLOBAL

The SEC will not shy from pursing internationally-based individuals or entities. Approximately one quarter of 2014 defendants – 29 of 113 total – were based overseas. Notably, 27 of these 29 foreign defendants were located in China or Hong Kong.

Two interesting trends emerge about these defendants. First, they have been more litigious than domestic defendants – approximately 55% of the China/Hong Kong defendants initially litigated their claims versus approximately 22% of domestic defendants. Second, the average civil penalty imposed on settling foreign litigants in 2014 was higher than the average amount imposed on settling defendants overall.



Yet the SEC is not limiting itself to China/Hong Kong, as illustrated by the June 2015 international information technology company case discussed in multiple places in this report.

Nor is the SEC limiting its international enforcement to public companies and their officers and directors. Four of the SEC's 2014 auditing standards cases – almost half – involved defendants located internationally (and sometimes with audit clients located abroad as well).[109]

These recent international auditor cases further punctuate the SEC's long-running dispute with the China-based subsidiaries of several large audit firms over the firms' production of audit workpapers located in China (and thus subject to China's state secrets laws). In 2014, the ALJ in this case ruled against the audit firms and ordered a six month suspension from practicing before the Commission.[110] In February 2015, the SEC and firms settled the dispute, with each of the named audit firms agreeing to pay a $500,000 civil penalty and admit their refusal to produce the documents (although the firms also neither admitted nor denied the SEC's other findings).[111]

It is too early to tell if 2015 will yield similar trends: only approximately 16% of defendants in the first half of 2015 were internationally based. In June 2015, however, the press reported that the PCAOB may soon conduct its first-ever inspection of an audit firm in China, perhaps resulting in additional international matters down the road.[112]

In light of the SEC's recent history of aggressively pursuing all types of enforcement matters throughout the world, entities and individuals located abroad cannot consider themselves immune from SEC enforcement trends.

(9) AP DOMINANCE

The SEC's increasing use of its home-court administrative forum has overshadowed much of the SEC's enforcement program in 2014 and early 2015. And it bears repeating that financial reporting and auditing matters were no exception, as detailed earlier in this review. The significant pushback on this trend has received prominent attention in the press, which we will not belabor here. Yet the negative ramifications for respondents due to the SEC's more frequent reliance on APs in complex financial reporting and auditing matters cannot be understated.[113]

In addition to decrying the trend, defendants are increasingly mounting Constitutional challenges to the SEC's use of APs.[114] In some instances, the challenges have succeeded, and courts have issued injunctions halting APs. Time will tell whether these challenges continue to gain traction, and whether the SEC will implement changes to its AP processes. In the meantime, entities and individuals involved in financial reporting and auditing matters must keep a wary eye on the SEC's potential litigation steps, in the event a matter progresses beyond the investigatory stage and cannot be settled.

(10) NEW INITIATIVES ON TAP

Two recent initiatives demonstrate the SEC's continued focus on rigorous financial reporting and auditing enforcement and oversight going forward.

(A) Clawbacks

First, as noted above, executive compensation clawbacks remain in the spotlight. On July 1, 2015, the SEC announced proposed rules on compensation clawback policies and procedures.[115] The proposed new Rule 10D-1 to the Exchange Act would require issuers, as a requirement for listing on a national securities exchange, to develop and implement clawback policies that align with the requirements in the rules, as well as to comply with certain disclosure requirements.

Specifically, an issuer's policies must specify that the issuer, in the event of an accounting restatement, will seek to clawback incentive-based compensation from current and former executives (Section 16 officers) that they would not have received based on the restatement. Importantly, clawbacks under the proposed rules apply on a strict liability basis – without regard to individual executives' fault or involvement in preparation of the financial statements.

Moreover, the proposed rule would mandate that issuers seek clawbacks except when "impractical," which may be narrowly defined to mean when a clawback is illegal under a non-U.S. issuer's home country or when the costs of a clawback exceed the amount to be recovered. Issuers who fail to adopt or follow their policies would be subject to delisting, at a minimum. The proposed rules also would impose reporting requirements about issuers' policies and clawback actions.

The proposed rules are not yet in effect. They were opened for public comment and the Commission is not time-limited in its consideration of the proposed rules and comments thereafter. Even then, the national securities exchanges must then propose and finalize their rules in accordance with the SEC's final Rule 10D-1.

Nevertheless, because the proposed rules may impact existing arrangements, companies and their executives are well-advised to analyze existing clawback policies, compensation arrangements, and other contracts (e.g., employment contracts, equity awards, change of control contracts, etc.) in light of the proposed rules. Companies also should examine their executive officer designations, particularly for current officers who are not statutorily enumerated.

(B) Audit Committees

Also on July 1, 2015, the SEC issued a concept release seeking public comment on 74 paragraphs containing questions about the sufficiency of current audit committee oversight and disclosure requirements.[116] The questions focus on three primary topics, as well as seek input about the form and timing of any new required disclosures.

The release first seeks comment on disclosures about the audit committee's oversight of auditors. Existing standards require an auditor to make certain required communications to the audit committee, and the audit committee report must disclose that the communications occurred. The concept release asks, among other things, whether the SEC should require more detailed disclosure about the content of those discussions and details about the auditors' conduct of the audit.

The release next seeks comment on disclosures about the audit committee's processes for appointing and retaining auditors. For example, the concept release asks whether the SEC should mandate disclosures about the rationale, criteria, and information used by the audit committee when selecting a particular auditor.

The release also seeks comment on disclosures about audit committee consideration of the qualifications of the audit firm and members of the engagement team. Most notably, the concept release asks whether to require disclosure of the names of the engagement partner and other key team members, as well as a summary of their experience. The concept release also asks about potential disclosure of the audit committee's input into selecting the engagement partner and duration of the auditor's tenure with the company.

The release underscores the SEC's view that audit committees play "an important role in protecting the interests of investors by assisting the board of directors in fulfilling its responsibility to oversee the integrity of a company's accounting and financial reporting processes and both internal and external audits."[117] In other words, regardless of what happens with the concept release, audit committees should expect to remain in the SEC's spotlight for the foreseeable future.

Conclusion

Financial reporting and auditing enforcement will continue to remain a focus for the SEC for the foreseeable future. In light of the takeaways and trends explored in this review, entities and individuals should carefully scrutinize their own practices promptly and appropriately address potential concerns that may arise.

Holland & Hart represents entities and individuals in virtually all aspects of securities enforcement, shareholder litigation, and white collar defense matters. We defend government and self-regulatory organization investigations, conduct internal investigations, litigate shareholder and business disputes, and conduct anti-foreign bribery assessments. Our team includes attorneys who were formerly with the U.S. Department of Justice and the U.S. Securities and Exchange Commission, a New York State Department of Financial Services independent economic sanctions monitor for a major financial institution, and a former officer in the United States Army. Learn more about Holland & Hart's Securities and White Collar Defense teams at www.hollandhart.com.

[1] See Speech, May 20, 2014, at http://www.sec.gov/News/Speech/Detail/Speech/1370541872207 (last visited May 26, 2015).
[2] The 2013 Review was published when I worked at my prior firm: http://media.mofo.com/files/Uploads/Images/140123-Financial-Reporting-Accounting-Enforcement-Annual-Review.pdf (last visited May 26, 2015).
[3] See Chairman's Address at SEC Speaks 2015, Feb. 20, 2015.
[4] Many thanks to Holland & Hart summer associate Ryan Yarrow for his assistance with this edition.
[5] Orders issued in previously-filed cases are excluded from these counts, such as court orders on dispositive motions or the parties' settlement of pending litigation. The excluded announcements also include orders issued in calendar year 2014 on individuals' requests to again practice before the Commission. The totals also do not include the February 3, 2014 announcement of a stop order proceeding against 20 purported mining companies that allegedly were controlled by a promoter who was previously barred by the SEC. Nor do the totals include March 13, 2015 actions against multiple officers, directors, or major shareholders for alleged failure to update their stock ownership disclosures, including with details about steps to take their companies private.
[6] See Remarks at Rocky Mountain Securities Conference, May 7, 2015.
[7] The 2013 Review grouped Auditor Independence cases together with other auditor cases under the auditing standards category. Given the significant focus on auditors in 2014 and early 2015 discussed in this report, the 2014 and early 2015 results are broken out.
[8] 2013 Review at 4 (brackets in original).
[9] Id.
[10] See, e.g., "The SEC is All Dressed Up…Now Where to Go?," Holland & Hart Client Alert, June 11, 2015, at http://www.hollandhart.com/the-sec-is-all-dressed-up/ (last visited Aug. 4, 2015).
[11] The SEC also initiated over one dozen "follow-on" APs, which are instituted after the conclusion of a federal district court action for the purpose of imposing relief such as a bar from practicing before the agency. Because follow-on APs do not typically involve additional substantive charges or allegations, they are not further analyzed in this Review.
[12] See 2013 Review at 6.
[13] See 2013 Review at 7.
[14] See Press Release 2014-47 (March 11, 2014).
[15] See, e.g., "The SEC is All Dressed Up…Now Where to Go?," Holland & Hart Client Alert, June 11, 2015, at http://www.hollandhart.com/the-sec-is-all-dressed-up/ (last visited June 16, 2015).
[16] The averages are calculated using both settled matters newly filed during the noted time period, as well as orders and settlements announced during that same time period in cases that were filed in prior years. The averages include only the amounts imposed by the SEC – they exclude sanctions contemporaneously imposed by other agencies (e.g., sanctions imposed by the DOJ).
[17] Excluding two $20 million outliers, the average civil penalty during 2014 is $278,320.
[18] Excluding a single $190 million outlier, the average civil penalty during the first half of 2015 is $1,703,330.
[19] Excluding a $2.48 million outlier, the average civil penalty for audit firms in 2014 was $23,700.
[20] Excluding two $20 million outliers, the average civil penalty for public companies in 2014 was $868,742.
[21] Excluding a $190 million outlier, the average civil penalty for public companies in the first half of 2015 was $7,387,761. Further excluding $55 million outlier, and the average was $3,059,375. And then excluding a $25 million outlier, the average was $865,313.
[22] Excluding a $20 million outlier, the average civil penalty for fraud charges in 2014 was $300,544.
[23] Excluding a $190 million outlier, the average civil penalty for fraud charges in the first half of 2015 was $98,333.
[24] Excluding a $20 million outlier, the average civil penalty for non-fraud charges in 2014 was $273,731.
[25] Excluding outliers of $55 million and $25 million, the average civil penalty for non-fraud charges in the first half of 2015 was $321,267.
[26] See AAER-3662 (June 5, 2015).
[27] See Release 2015-99 (May 26, 2015).
[28] See Release 2015-93 (May 20, 2015).
[29] See Release 2014-172 (Aug. 21, 2014).
[30] See AAER-3549 (Apr. 8, 2014).
[31] See FY 2016 Congressional Justification & FY2014 Annual Performance Report and FY 2016 Annual Performance Plan (Feb. 2, 2015) at http://www.sec.gov/about/reports/secfy16congbudgjust.shtml (last visited July 28, 2015).
[32] See Release 2014-106 (May 27, 2014).
[33] See Release 2014-106 (May 27, 2014).
[34] See Remarks at Rocky Mountain Securities Conference, May 7, 2015.
[35] See Release No. 2014-272 (Dec. 8, 2014).
[36] See AAER-3566 (July 14, 2014).
[37] See AAER-3530 (Jan. 24, 2014).
[38] See Release 71390 (Jan. 24, 2014).
[39] See https://www.sec.gov/litigation/investreports.shtml (last visited July 26, 2015).
[40] See AAER-3668 (July 1, 2015). This matter is not included in the case metrics discussed above because it was announced one day after the date cut-off for tallying those metrics.
[41] See Release 2014-272 (Dec. 8, 2014).
[42] See AAER-3587 (Sept. 25, 2014).
[43] See AAER-3554 (May 20, 2914).
[44] See AAER-3592 (Oct. 24, 2014).
[45] See AAER-3628 (Feb. 6, 2015).
[46] See "SEC Receives At Least One Audit Independence Query Daily," CFO Journal, Wall Street Journal, May 12, 2015.
[47] See Id.; Brian Croteau, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014; and Kevin Stout, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014.
[48] See AAER-3529 (Jan. 17, 2014); AAER-3562 (July 1, 2014); AAER-3555 (May 20, 2014).
[49] See AAER-3537 (Feb. 20, 2014); AAER-3529 (Jan. 17, 2014); AAER-3555 (May 20, 2014); AAER-3562 (July 1, 2014).
[50] See AAER-3529 (Jan. 17, 2014); AAER-3562 (July 1, 2014).
[51] See AAER-3537 (Feb. 20, 2014); AAER-3529 (Jan. 17, 2014); AAER-3555 (May 20, 2014); AAER-3565 (July 8, 2014).
[52] See AAER-3537 (Feb. 20, 2014); AAER-3529 (Jan. 17, 2014).
[53] See AAER-3537 (Feb. 20, 2014); AAER-3555 (May 20, 2014).
[54] See AAER-3565 (July 8, 2014); AAER-3562 (July 1, 2014); AAER-3555 (May 20, 2014); AAER-3615 (Dec. 17, 2014).

[55] See AAER-3639 (Feb. 23, 2015).
[56] See AAER-4130 (June 25, 2015).
[57] The term "officer" is used loosely in this report to refer to any employee of a public company who is not a director or outside auditor.
[58] See "Wall Street's Cop Takes Harder Line. SEC steps up penalties against individuals as part of Mary Jo White's get-tough approach," Wall Street Journal, Jean Eaglesham and Andrea Fuller, July 14, 2015.
[59] See AAER-3662 (June 5, 2015).
[60] See AAER-3584 (Sept. 24, 2014). The SEC also later obtained approximately $480,000 in clawbacks from two former CFOs of the same company. See AAER-3636 (Feb. 10, 2015).
[61] See AAER-3596 (Nov. 12, 2014).
[62] See Release 2014-125 (June 25, 2015).
[63] See Release 2014-125 (June 25, 2015).
[64] Of course, this is the title of Chairman Arthur's Levitt famous September 1998 speech at NYU Center for Law and Business. Full text at https://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.
[65] See Release 2014-47 (Mar. 11, 2014) and Release 71687 (Mar. 11, 2014).
[66] See Release 2014-269 (Dec. 3, 2014); see also AAER-3528 (Jan. 15, 2014).
[67] See AAER-3583 (Sept. 28, 2014).
[68] See AAER-3578A (Aug. 28, 2014).
[69] See AAER-3613 (Dec. 15, 2014).
[70] See AAER-3585 (Sept. 25, 2014).
[71] See AAER-3576 (Aug. 22, 2014).
[72] See ASU 2014-09 (May 28, 2014).
[73] See, e.g., James Schnurr, "Remarks before the 2014 AICPA National Conference on Current SEC and PCAOB Developments," Dec. 8, 2014.
[74] See AAER-3527 and AAER-3526 (Jan. 9, 2014).
[75] See AAER-3582 (Sept. 11, 2014); see also AAER-3559, AAER-3560, and Release 2014-125 (June 25, 2014).
[76] See AAER-3662 (June 5, 2015).
[77] See Release 2014-106 (May 27, 2014).
[78] See also AAER-3641 (Mar. 2, 2015).
[79] See AAER-3548 and AAER-3549 (Apr. 8, 2014).
[80] See AAER-3647, AAER-3648, and AAER-3649 (Apr. 1, 2015).
[81] See AAER-3662 (June 5, 2015).
[82] See Release 2014-158 (Aug. 4, 2014).
[83] See AAER-3545 (Mar. 27, 2014).
[84] See AAER-3638 (Feb. 13, 2015).
[85] See Release No. 2014-51 (Mar. 13, 2014).
[86] See Litigation Release No. 23096 (Sept. 29, 2014).
[87] See Release 2014-190 (Sept. 10, 2014) and Release 2014-191 (Sept. 10, 2014).
[88] See, e.g., "Internal Control Reporting An Area of Focus at SEC," Edith Orenstein, Mar. 3, 2014, Financial Reporting Blog at http://www.financialexecutives.org/KenticoCMS/FEI_Blogs/Financial-Reporting-Blog/March-2014/Internal-Control-Reporting-An-Area-of-Focus-at-SEC.aspx#axzz3hDrFqwJf (last accessed July 28, 2015); Brian Croteau, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014; and Kevin Stout, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014.
[89] See Brian Croteau, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014; and Kevin Stout, Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2014.
[90] See Release 2014-106 (May 27, 2014).
[91] See Release 2014-106 (May 27, 2014) at Complaint para. 15.
[92] See also, e.g., AAER-3582 (Sept. 11, 2014) (allegedly deficient controls prevented timely consideration of past due loans on bank's reserve); AAER-3600 (Dec. 5, 2014) (alleging deficient controls in connection with recording of deferred tax asset); AAER-3585 (Sept. 25, 2014) (allegedly deficient controls led to incorrect revenue recognition).
[93] See also, e.g., AAER-3593 (Oct. 27, 2014) (company agrees to pay $150,000 civil penalty to settle claims of allegedly misstated revenues, in part due to company's investigation and remediation); AAER-3571 (July 28, 2014) (SEC recognized cooperation by company settling FCPA claims, with company agreeing to pay $1.9 million civil penalty and to certain undertakings).
[94] See "Does SOX 404 Have Teeth? Consequences of the Failure to Report Existing Internal-Control Weaknesses," Sarah C. Rice (Texas A&M University) and David P. Weber (University of Connecticut) in The Accounting Review, American Accounting Association, at http://aaahq.org/Outreach/Newsroom/Press-Releases/4-28-15-SOX-404 (last visited Aug. 6, 2015).
[95] See AAER-3573 (July 30, 2014) and AAER-3572 (July 30, 2014).
[96] See Remarks at Rocky Mountain Securities Conference, May 7, 2015.
[97] See Release 2015-93 (May 20, 2015).
[98] See PCAOB Release No. 2014-002 (June 10, 2014).
[99] See Release 2015-65 (Apr. 9, 2015).
[100] See 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program at http://www.sec.gov/about/offices/owb/annual-report-2014.pdf (last visited Aug. 4, 2015).
[101] See "The SEC as the Whistleblower's Advocate," Chair White, (Apr. 30, 2015) at http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html (last visited Aug. 4, 2015).
[102] See "The Impact of Whistleblowers on Financial Misrepresentation Enforcement Action," Andrew Call (Arizona State University), Gerald Martin (American University), Nathan Sharp (Texas A&M University), and Jaron Wilde (University of Iowa), Oct. 6, 2014.
[103] See 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program at http://www.sec.gov/about/offices/owb/annual-report-2014.pdf (last visited Aug. 4, 2015).
[104] See Release 2014-206 (Sept. 22, 2014).
[105] See Release 2015-54 (Apr. 1, 2015).
[106] See Release 2015-75 (Apr. 28, 2015).
[107] See "Two Million More Reasons to Appropriately and Promptly Address Reports of Potential Wrongdoing," Brian Neil Hoffman, Holland & Hart News Update, June 11, 2015 at http://www.hollandhart.com/address-reports-of-potential-wrongdoing/ (last visited Aug. 4, 2015).
[108] See "The SEC as the Whistleblower's Advocate," Chair White, (Apr. 30, 2015) at http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html (last visited Aug. 4, 2015).
[109] See AAER-3562 (July 1, 2014); AAER-3555 (May 20, 2014); AAER-3565 (July 8, 2014); AAER-3615 (Dec. 17, 2014).
[110] See In re BDO China Dahua et al., AP Nos. 3-14872, 3-15116, Initial Decision (Jan. 22, 2014).
[111] See Release 2015-25 (Feb. 6, 2015).
[112] See "U.S. regulators plan first-ever inspection of audit firm in China," Reuters, June 29, 2015 at http://www.reuters.com/article/2015/06/29/us-audits-china-idUSKCN0P92TE20150629 (last visited Aug. 6, 2015).
[113] See, e.g., "The SEC is All Dressed Up…Now Where to Go?," Holland & Hart Client Alert, June 11, 2015, at http://www.hollandhart.com/the-sec-is-all-dressed-up/ (last visited Aug. 4, 2015).
[114] See, e.g., Hill v. SEC, No 1:15-cv-01801-LMM, N.D. Ga.; Duka v. SEC, No. 15-00357, S.D.N.Y.
[115] See Release 2015-136 (July 1, 2015).
[116] See Release 2015-138 (July 1, 2015).
[117] 17 CFR part 240, Release 33-9862 and 34-75344, File No. S7-13-15, at 6 (July 1, 2015).

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