Floyd Advisory

Summary of Accounting and Auditing Enforcement Releases for the Year Ended December 31, 2014

ANNUAL REPORT 2014

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Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission, Division of Enforcement's Accounting and Auditing Enforcement Releases ("AAERs") for the year ended December 31, 2014.

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 intend to fulfill this commitment.

The Division of Enforcement at the U.S. Securities and Exchange Commission ("SEC") is a law enforcement agency established to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. As such, the actions they take and releases they issue provide very useful interpretations and applications of the securities laws.

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

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

Floyd Advisory
JANUARY 2015

Our Process and Methodology

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

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

As part of our review, we gathered information and key facts, identified common attributes, noted trends, and observed material events. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (e.g., Rule 102(e) Actions, Financial Reporting Frauds, Foreign Corrupt Practices Act violations ("FCPA"), Reinstatements to Appear and Practice before the SEC, Violations of Books and Records, and Other) and classifications of the financial reporting issues involved (e.g., Improper Revenue Recognition, Manipulation of Reserves, Intentional Misstatement of Expenses, Balance Sheet Manipulation, Options Backdating and Defalcations). Do note, when a release included more than one allegation, admission, or violation, we placed the release into the category which represented the most significant issue. For our summary of financial reporting issues, we recorded each accounting problem identified as a separate item. Based on this process and methodology, we prepared a database of the key facts in each release.

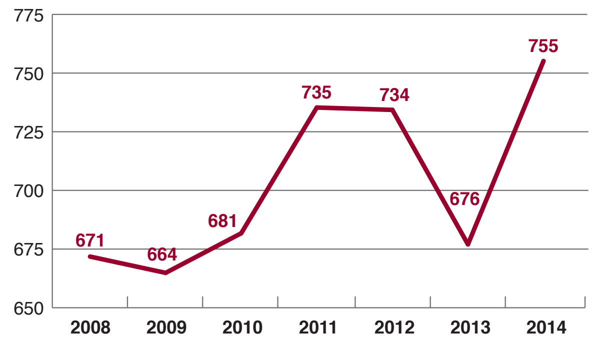
REVIEW PROCESS

- Gathered information and key facts
- Identified common attributes
- Noted trends
- Observed material events
- Sorted the releases into major categories
- Prepared a database of the key facts

SEC Enforcement Actions: 2014 Volume Surpasses Previous Highs

Before summarizing information related to the 2014 population of AAERs, summarizing the SEC's overall enforcement actions provides insights into the trends and types of actions receiving the most attention. As reflected on the chart to the right, the volume of actions filed for the year ended September 30, 2014 increased approximately 12% from 2013 results and surpassed previous record levels.

Total SEC Enforcement Actions
For The Years Ended September 30,



SEC Enforcement Actions for the Year Ended September 30, 2014:

755

To dig further into these numbers, the following table provides data on the categories of actions filed annually for the years ended September 30, 2003 through September 30, 2014.

SEC Categorization of Enforcement Actions
For the Years Ended September 30,

Enforcement Actions by Fiscal Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Broker-Dealer	137	140	94	75	89	67	109	70	112	134	121	166
Delinquent Filings	n/a	n/a	n/a	91	52	113	92	106	121	127	132	107
FCPA	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	20*	15	5	7
Issuer Reporting and Disclosure	199	179	185	138	219	154	143	126	89**	79	68	99
Insider Trading	50	42	50	46	47	61	37	53	57	58	44	52
Investment Adviser/ Investment Co.	72	90	97	87	79	87	76	113	146	147	140	130
Market Manipulation	32	39	46	27	36	53	39	34	35	46	50	63
Securities Offering	109	99	60	61	68	115	141	144	124	89	103	81
Other	80	50	98	49	65	21	27	35	31	39	13	50
Total Enforcement Actions	**679**	**639**	**630**	**574**	**655**	**671**	**664**	**681**	**735**	**734**	**676**	**755**

*Prior to FY 2011, FCPA was not a distinct category and FCPA actions were classified as Financial Fraud/Issuer Disclosure, a category that is now Issuer Reporting and Disclosure.
**Prior to FY 2011, this category included FCPA Actions, which are now tracked as a distinct category.
Source: https://www.sec.gov/news/newsroom/images/enfstats.pdf

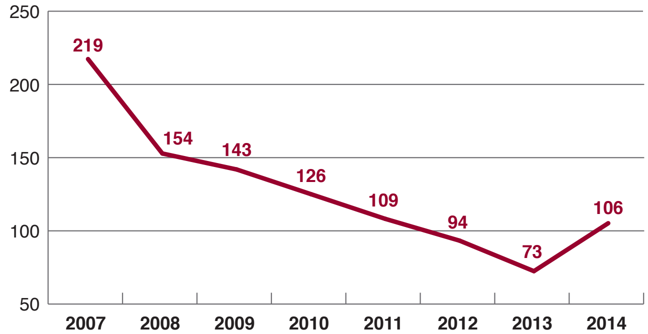
Definitions of these categories were not readily available from either the SEC's *Fiscal Year 2014 Agency Financial Report*, but based on examples of actions in each category and our experience, we prepared the following summary of the types of enforcement actions expected to be classified in each category.

Category	Types of Enforcement Actions
Broker-Dealer	Stock price manipulation, violations arising out of compliance deficiencies, naked short selling schemes, improper trading activities by Broker-Dealers
Delinquent Filings	Failures to make required and or timely filings with the SEC including Forms 10K, 10Q, 8K, and other mandated submissions
FCPA	Bribes and kickbacks to foreign officials to assist in obtaining or retaining business as well as cases involving internal control violations
Issuer Reporting and Disclosure	Fraudulent financial reporting matters, cases involving misleading statements to investors, and faulty and/or inadequate disclosure matters
Insider Trading	Buying or selling a security in breach of a fiduciary duty or other relationship of trust and confidence while in possession of material, nonpublic information about the security
Investment Adviser/Investment Company	Misleading disclosures, improper fee arrangements, misappropriation of client assets, market manipulation, and other violations of the Investment Advisers Act
Market Manipulation	Creating false appearance of a liquid and active market, fraud involving dormant microcap shell companies, and other disruptive trading activities
Securities Offering	Misleading and fraudulent representations to induce investors to enter into securities transactions

Uptick in the category formerly known as "Financial Fraud/Issuer Disclosure"

The SEC reclassified the "Financial Fraud/Issuer Disclosure" category in 2014 to "Issuer Reporting and Disclosure," notably removing the reference to "fraud," without any footnote explanation supporting the table on page 2. The filings in this newly classified category increased approximately 45% compared with 2013. This is the first rise in enforcement actions in this category since 2007.

Issuer Reporting/Disclosure/FCPA Enforcement Actions
For The Years Ended September 30,



Issuer Reporting/ Disclosure/FCPA Enforcement Actions for the Year Ended September 30, 2014:

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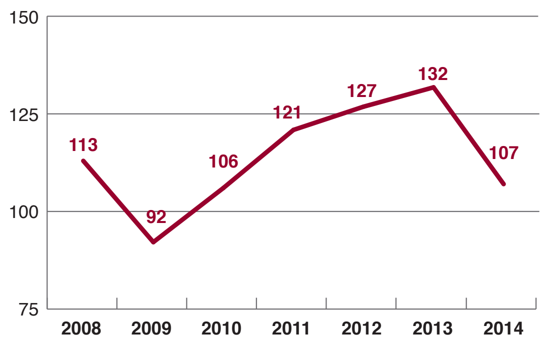
This increase indicates a break in the trend and reflects the SEC's increased focus on financial reporting cases over the last four quarters. In its *Fiscal Year 2014 Agency Financial Report*, the SEC stated they will continue the momentum in pursuing financial reporting and accounting fraud cases. These efforts will include leveraging the work of the SEC's Division of Enforcement's Financial Reporting and Audit Task Force, which focuses on identifying violations relating to the preparation of financial statements, issuer reporting and disclosure, and audit failures.

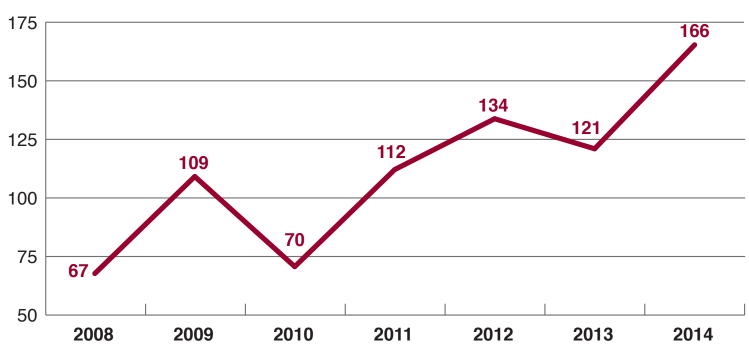
In contrast to Issuer Reporting and Disclosure enforcement actions, the chart to the right illustrates the number of enforcement actions related to Delinquent Filings. This category had been steadily increasing for years only to experience its first drop since 2009. Before 2014, Delinquent Filings was the only category to show a consistent pattern of increases since 2009. It appears that after sustained upward success pursuing Delinquent Filings cases, the SEC has shifted its focus to other enforcement areas.

Delinquent Filings
For The Years Ended September 30,



The number of Broker-Dealer enforcement actions reached a new peak in 2014 with 166 actions. This is almost 25% more than the previous peak we observed in 2012. In fact, 2014 accommodated more Broker-Dealer enforcement actions than any other enforcement category, approximately 22% of actions overall. The increase coincides with a requirement imposed in July 2013 compelling auditors of broker-dealers to perform their audits in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB"). Any correlation drawn might imply that newly-registered firms unaccustomed to performing under changed standards, particularly in regards to independence, have been more prone to the errors that would lead to enforcement actions. We discuss the application of PCAOB standards on page 10 of this report.

SEC Broker-Dealer Enforcements
For The Years Ended September 30,



"In a renewed effort to combat accounting frauds, the SEC in June 2013 established a Financial Reporting and Audit Task Force. This is an essential area for enforcement focus—accurate, honest and reliable financial reporting is at the core of market integrity and investor protection. This task force has taken advantage of new sources of data on financial reporting, using innovative analytical tools to more quickly identify potential issues in financial statements and disclosures that merit further investigation."

Mary Jo White, Chair
IOSCO 39th Annual Conference
Rio de Janiero
Oct. 1, 2014

The Challenge of Coverage, Accountability and Deterrence in Global Enforcement

Update on Admissions of Guilt

In June 2013, SEC leadership announced an initiative that would require admissions of wrongdoing by defendants as a condition of settlement. This was not the first time the SEC has updated its settlement policy. In 2012, the SEC announced that admissions of guilt would be required from parties that pled guilty in parallel criminal actions. This latest initiative marked an evolution of the SEC's long-standing policy of allowing cases to be resolved with a "no admit/no deny" settlement. SEC Chair Mary Jo White outlined the following applicable scenarios where admissions may be appropriate:

- Cases where a large number of investors have been harmed or the conduct was otherwise egregious
- Cases where conduct posed a significant risk to the market or investors
- Cases where admissions would aid investors deciding whether to deal with a particular party in the future
- Cases where citing unambiguous facts would send an important message to the market about a particular case[1]

Pursuing an admission of guilt is a costly and time-consuming process, and many defendants would rather take their chances at trial than admit their liability, thereby making themselves vulnerable to shareholder litigation, criminal proceedings, and state regulatory actions. Avoiding trial also means that investors receive their money more quickly. For these reasons, Chair White concedes that the standard "no admit/no deny" policy will remain a "major, major tool" that will still apply to "a majority of cases."[2] At the same time, Chair White has emphasized the SEC's willingness to try more cases for the purposes of transparency and accountability, giving a speech in November 2013 entitled "The Importance of Trials to the Law and Public Accountability." With this message, it seems clear that the SEC will be extremely selective with when and why it will require an admission of guilt, while gathering its resources to make sure that those cases deemed particularly "egregious" will be settled as efficiently as possible.

In the fiscal year ended September 30, 2014, the SEC enforcement produced twelve pacts involving an admission of wrongdoing,[3] with an additional two identified in Q4 of 2014. This is a substantial increase from 2013 and encompasses a wide range of offenses, penalties, and industries. Four cases, all having to do with misconduct stemming from the financial crisis, had settlements of more than $100 million each. As an explanation of the choice of cases with admissions of wrongdoing, SEC enforcement chief Andrew Ceresney states that all twelve admissions "are important cases that warranted admissions, which enhanced the defendants' acceptance of responsibility for their actions."[4] Rather than cherry-picking cases that are the most high-profile or involve the biggest penalties, the SEC is sending the message that no case is safe from their scrutiny.

"There is nothing quite like a company or corporate executive who violated the securities laws openly and publicly admitting their guilt. That acknowledgment, in turn, boosts investors' confidence in the SEC's enforcement program and in our markets. Admissions also serve as a strong deterrent to would-be violators of our securities laws, and as a clear warning sign for future would-be victims of the defendant. We will continue in the coming year to obtain more admissions in more cases where it is important to do so."

Mary Jo White, Chair
IOSCO 39th Annual Conference
Rio de Janiero
Oct. 1, 2014

The Challenge of Coverage, Accountability and Deterrence in Global Enforcement

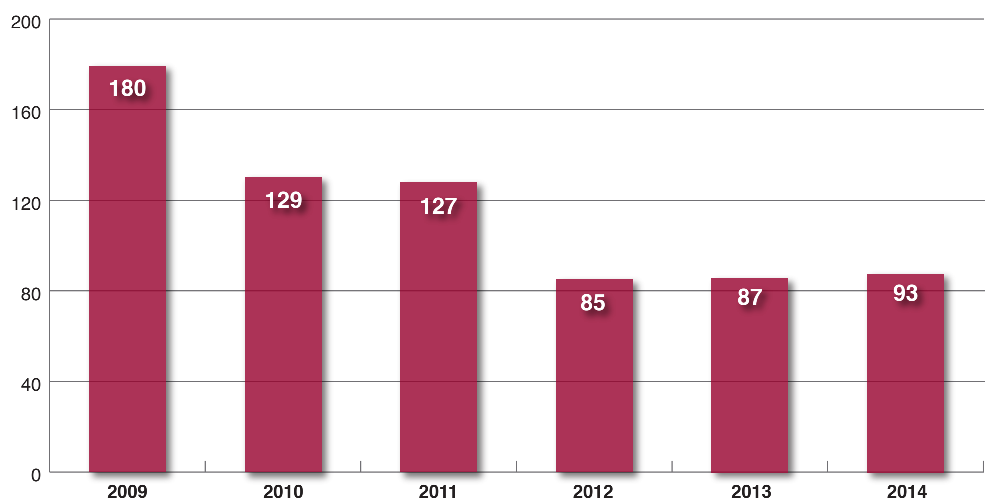
[1] White, Mary Jo. "Deploying the Full Enforcement Arsenal." Council of Institutional Investors fall conference. Chicago, IL. Sept. 26, 2013.
[2] Gongloff, Mark. "SEC To Seek Admissions of Wrongdoing, Sometimes, Occasionally: Mary Jo White" The Huffington Post 19 June 2013. Web. 22 Jan. 2014
[3] Eaglesham, Jean. "As SEC Enforcement Cases Rise, Big Actions Are Sparse." Wall Street Journal 29 Sept. 2014. Web. 16 Dec. 2014.
[4] Ibid.

AAERs for Year Ended December 31, 2014: Major Observations and Insights

For the year ended December 31, 2014, the SEC issued 93 AAERs, representing a slight increase in the volume of AAERs reported over the last two years. But this is still significantly lower than the volume of AAERs issued by the SEC in preceding years. The volume of AAERs in 2014 represents 48% fewer enforcement releases than 2009.

For the year ended December 31, 2014, the SEC issued 93 AAERs, representing a slight increase in the volume of AAERs reported over the last two years.

Looking Back at Total AAERs in Preceding Years
For The Periods January 1 – December 31,

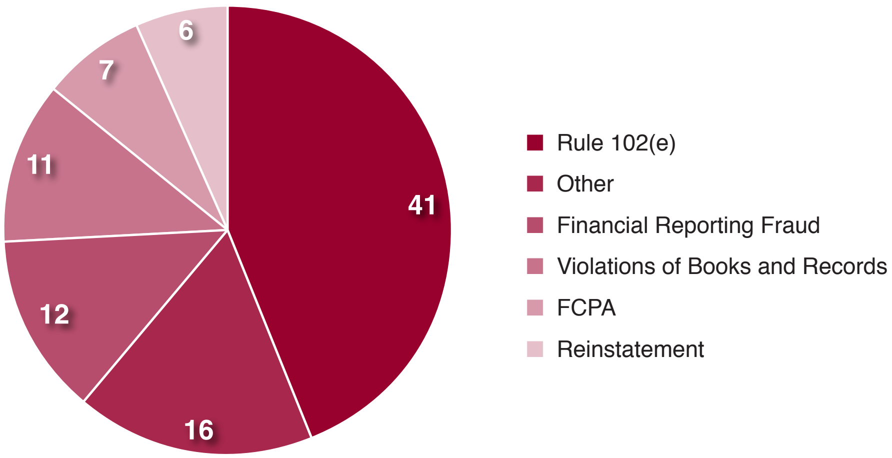


To evaluate the correlation between the volume of total enforcement actions and the increase in AAERs, we must consider the types of matters being handled by the SEC. Importantly, AAERs are intended to highlight certain enforcement actions related to auditing and accounting, and are not meant to be a complete and exhaustive compilation of all the actions that may fit into the definition the SEC provides for this classification. Furthermore, in our experience, AAERs quite often arise out of cases including matters related to issuer reporting and disclosure, and instances of this type have increased within the total number of SEC enforcement actions.

102(e) Enforcement Actions Consistently Earn the Top Position

To evaluate the type of AAERs issued in 2014, we sorted the releases into major categories: Financial Reporting Frauds, Rule 102(e) Actions, Foreign Corrupt Practices Act violations ("FCPA"), Violations of Books and Records, Reinstatements, and Other. Rule 102(e) matters dominated 2014 releases, accounting for over 40% of the reported AAERs. No other classification has so dominated the AAER population over the past two years.

2014 AAERs by Category



Releases surrounding Financial Reporting Fraud dropped by 45% from 2013 while Violations of Books and Records slightly increased.

Rule 102(e) actions involve the censure and denial, temporary or permanent, of the privilege of appearing or practicing before the SEC. For accountants, the standards under which one may be penalized with a Rule 102(e) action include reckless or negligent conduct, defined as a single instance of highly unreasonable conduct that violates professional standards, or repeated instances of unreasonable conduct resulting in a violation of professional standards that indicate a lack of competence.

Typically, events that trigger enforcement actions result in numerous 102(e) actions against individuals involved, which may explain the consistent dominance of 102(e) actions over any other category from year to year. As discussed later in our report, the average lag from the beginning of the alleged violation to the filing of the AAER and resolution for the Rule 102(e) matters was approximately 5.5 years with the longest being almost 13 years before finality.

Compared to last year, the number of Financial Reporting Fraud releases dropped 45%, while Violations of Books and Records increased slightly. The Violations of Books and Records category includes allegations of improper accounting treatments and internal control problems deemed worthy of an enforcement action, but not warranting the stiffer penalties associated with Financial Reporting Fraud.

The 2014 AAERs: Summary of Financial Reporting Issues

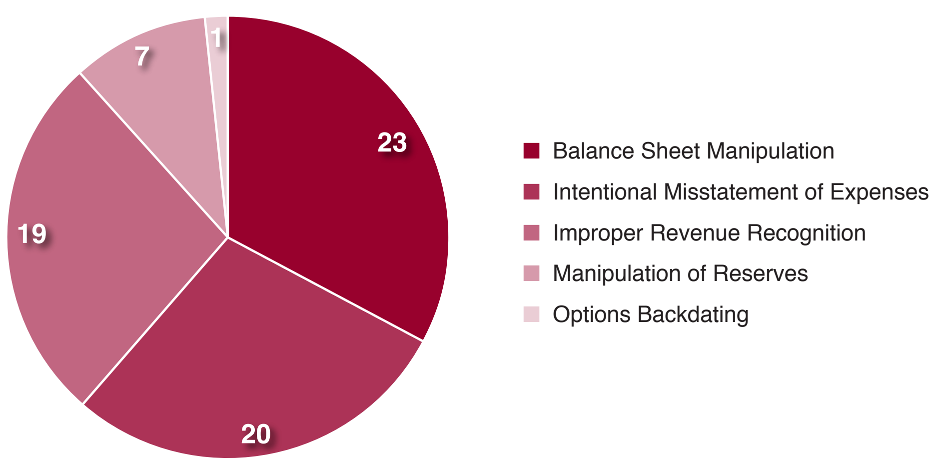
To report on the frequency of financial reporting issues involved in 2014 AAERs, we identified the accounting problem(s) in each AAER based on the classification definition below:

Classification	Definition
Improper Revenue Recognition	Overstated, premature, and fabricated revenue transactions reported in public filings
Manipulation of Reserves	Improperly created, maintained, or released restructuring reserves, general reserves, and other falsified accruals
Intentional Misstatement of Expenses	Deceptive misclassifications and understatements of expenses
Balance Sheet Manipulation	Misstatement and misrepresentation of asset balances and the recording of transactions inconsistent with their substance
Defalcation	Thefts of funds and assets
Options Backdating	Intentional misdating of stock option awards

Some of the most common balance sheet manipulation schemes we observed included overvalued inventory on the issuer's books, overstated cash balances, and inflated fixed assets.

As shown below, balance sheet manipulation represented the most common financial reporting issue in the 2014 AAER population. Importantly, as described in the "Our Process and Methodology" section, we record each accounting problem identified in the releases as a separate item and therefore many actions involving improper revenue recognition, manipulation of reserves, and the intentional misstatement of expenses also have a balance sheet impact.

Financial Reporting Issues Identified in 2014 AAERs



PCAOB, FASB, and IASB Provide Guidance on Revenue Recognition

Improper Revenue Recognition received special attention from the PCAOB in 2014. It was the most prevalent issue in the third quarter, and in September, the PCAOB issued Staff Audit Practice Alert No. 12, *Matters Related to Auditing Revenue in an Audit of Financial Statements*. This practice alert highlights certain PCAOB standards related to aspects of auditing revenue in which significant auditing deficiencies have been frequently observed by PCAOB inspectors. Specifically, the alert discusses:

- Testing the recognition of revenue from contractual arrangements
- Evaluating the presentation of revenue—gross versus net revenue
- Testing whether revenue was recognized in the correct period
- Evaluating whether the financial statements include the required disclosures regarding revenue
- Responding to risks of material misstatement due to fraud associated with revenue
- Testing and evaluating controls over revenue
- Applying audit sampling procedures to test revenue
- Performing substantive analytical procedures to test revenue
- Testing revenue in companies with multiple locations

In May of 2014, the Financial Accounting Standards Board and the International Accounting Standards Board jointly issued new revenue recognition standards that are effective for periods beginning after December 15, 2016. These new standards, intended in part to eliminate inconsistencies within GAAP, may have a significant impact on certain industries, such as software and real estate. Although the effective date seems far off, many companies are already working on implementation plans. This transition will certainly be a significant area of focus for the SEC and the level of success related to the implementation of this new guidance may be reflected in the volume of future AAERs related to revenue recognition.

"As companies work to implement the FASB and IASB's newly converged standard on revenue recognition it is important to give early and ongoing consideration to implementing new controls or redesigning existing controls where necessary."

Brian T. Croteau
Deputy Chief Accountant
Office of the Chief Accountant
Dec 8, 2014

Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments

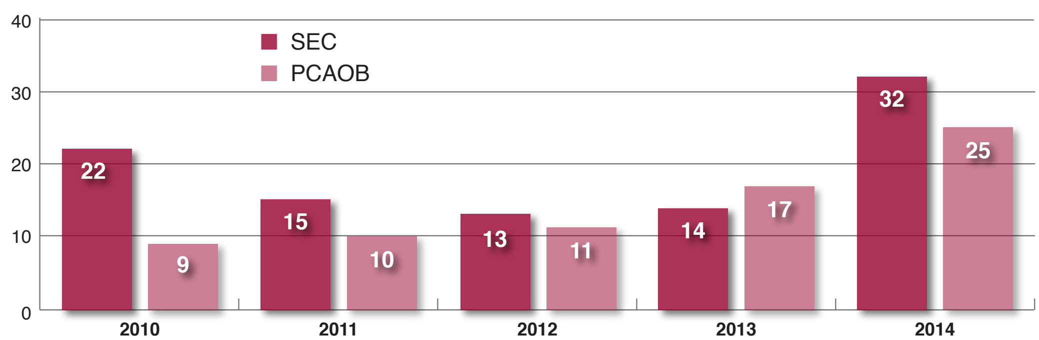
Notable Trends and Observations in AAERs

As the fourth year of our reporting on AAERs has drawn to a close, we have noticed some significant trends in the SEC's activities. We have highlighted a few of our key observations below, including a look at actions against auditors, the pace of reporting AAERs, and an analysis of enforcement against FCPA violations. We are excited to offer these analyses, and are keenly interested to see if the patterns we have observed set a trend for AAERs for the coming years.

Actions Against Auditors: A Two-Fisted Enforcement Policy

From reviewing the AAERs related to auditors, we noted that levels of activity have sharply increased in 2014, with SEC audit-related enforcement actions more than doubling. PCAOB enforcement actions against auditors also increased, continuing a five-year trend, as illustrated in the accompanying chart. The uptick suggests that auditors have been highly scrutinized by both SEC and PCAOB throughout 2014. Eight of the audit-related AAERs in 2014 related to enforcement actions against China-based affiliates of the "Big Four" audit firms, which is consistent with our observation in previous periods of a trend in enforcement actions in China.

SEC and PCAOB Audit-Related Enforcement Actions
For The Years Ended December 31,



Both the SEC and PCAOB have authority to bring enforcement actions against auditors, however, PCAOB disciplinary actions against auditors are subject to SEC review. In certain cases, the PCAOB investigates the auditor's conduct while the SEC focuses its investigation on the company, its management, and other related parties. In other cases, the SEC's Division of Enforcement takes responsibility for an auditor investigation and requests that the PCAOB defer.[5] Overall, 2014 saw increased activity from both the SEC and PCAOB on both an individual and combined basis. The two regulatory bodies were more active than ever with regard to bringing enforcement actions against the audit industry.

The following chart shows the number of times each of the violations of generally accepted auditing standards took place. Note that each enforcement action typically contains more than one violation.

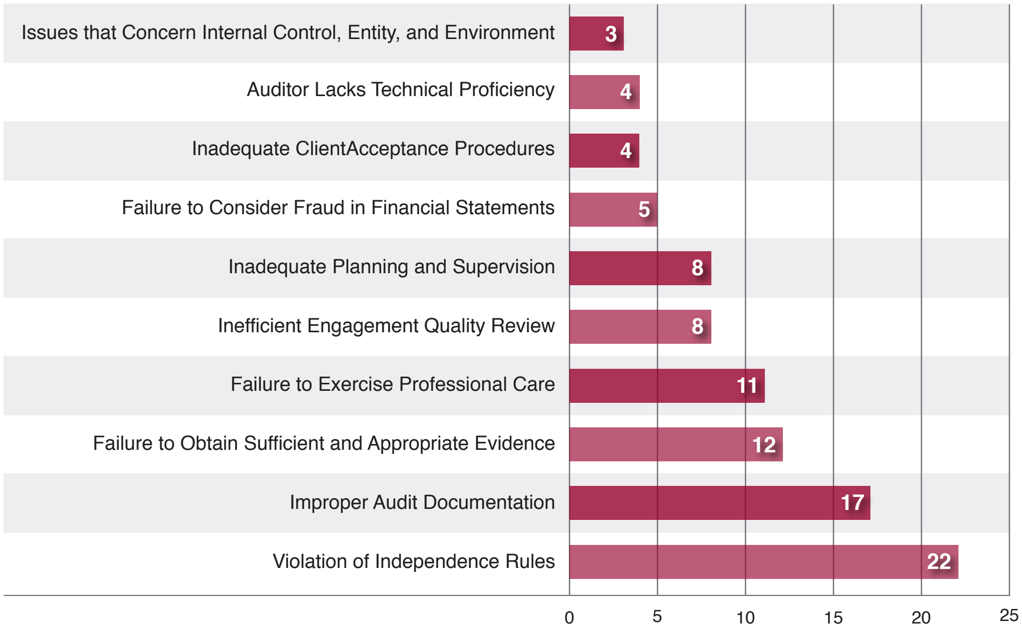
"As part of its ongoing assessment of 'what could go wrong' within a financial reporting element, it is critical that management consider the nature and extent of any changes in the risks to reliable financial reporting. Such changes can result from a variety of sources, including company reorganization, nature of transactions entered into, overall business environment, and accounting requirements."

Kevin M. Stout
Senior Associate Chief Accountant
Office of the Chief Accountant
Washington, D.C.
Dec. 8, 2014

Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments

[5] Doty, James R. "What's Changed: New Frontiers for Auditors Without Borders." 19th Annual SMU Corporate Counsel Symposium. TX, Dallas. 14 Oct. 2011. PCAOB. Web. 16 Dec. 2014.

Prevailing Audit Issues within SEC and PCAOB Audit-Related Enforcement Actions



Violations of auditor independence rules was the most prevalent issue noted in enforcement actions during the year. A significant portion of these enforcement actions became public in the last quarter of 2014 and were related to audits of broker-dealers, which appear to have been a focus for the PCAOB and the SEC. Beginning in July 2013, auditors of broker-dealers were required to perform their audits in accordance with the standards of the PCAOB.[6] For a number of firms, this has resulted in first-time registration with the PCAOB. We observed a number of enforcement actions in which the auditor was heavily involved in maintaining the books and records of the broker-dealer, including the preparation of financial statements. The PCAOB recently issued staff guidance on audits of broker-dealers to highlight specific requirements and provide guidance on the application of PCAOB standards to these engagements.[7]

> **"High-quality audits performed objectively by independent auditors support investor confidence in financial reporting. Independence in both fact and appearance is foundational to an audit and necessary to reduce threats to auditor objectivity and to promote credibility."**
>
> **Brian T. Croteau**
> **Deputy Chief Accountant**
> **Office of the Chief Accountant**
> **Washington, D.C.**
> **Dec. 8, 2014**
>
> **Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments**

FCPA Cases: What Goes Down Must Come Up?

There were seven reported FCPA AAERs in 2014, an increase from 2013, but still down from the number that were issued three years ago. When observing the numbers, one wonders if this indicates that a number of cases are in the pipeline, or if the SEC is currently focused on other enforcement areas.

AAERs: FCPA Cases

For The Years Ended December 31,

*Inclusive of Issuer Reporting and Disclosure and FCPA matters

6 "Highlights of the 2014 AICPA National Conference on Current SEC and PCAOB Developments." PricewaterhouseCoopers. 15 Dec. 2014. Web.

7 Croteau, Brian T. "Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments." Washington, D.C. 8 Dec. 2014. Web. 16 Dec. 2014.

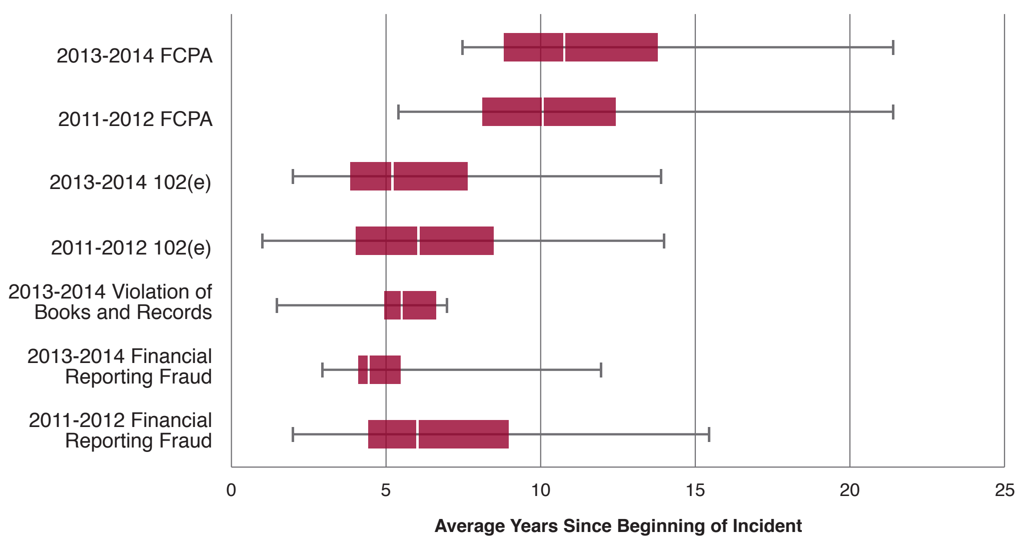
We may not expect to see a great number of new FCPA-related AAERs arising out of the ongoing global deal activity boom. Following a recent inquiry by a US company that was in the process of buying a foreign company, the US Department of Justice announced in a release that "[s]uccessor liability does not, however, create liability where none existed before. For example, if an issuer were to acquire a foreign company that was not previously subject to the FCPA's jurisdiction, the mere acquisition of that foreign company would not retroactively create FCPA liability for the acquiring issuer."[8]

FCPA Violations Still Linger Longest

The box-and-whisker plot below reflects the length of average time between the beginning year of the violation and the release for all reported AAERs for the years as labeled. The median is denoted by the center line in each box and the endpoints of the "whiskers" represent the minimum and maximum ages of the incidents. The sides of the boxes represent the first and third quartiles, therein indicating the most common ages for incidents in each category.

For 2014, the average "age" of incidents reported in AAERs was 5.8 years, noticeably lower than the 6.7 year average age for the years 2011 through 2013.

Age Trend Analysis of AAER Categories



Notes: The analysis is assuming midyear convention
Violations of Books and Records was only analyzed as of 2013

For 2014, the average "age" of incidents reported in AAERs was 5.8 years, noticeably lower than the 6.7 year average age for the years 2011 through 2013. It's clear that the age of incidents, when categorized by type, follows a distinct pattern (see chart above). Once again, the age of FCPA incidents far outlasts that of other categories. This is likely due to the difficulty in pursuing these cases, which often occur overseas and require the cooperation of other countries. When comparing the age of 2013/2014 AAERs with those from 2011/2012, the most noticeable shift is that of Financial Reporting Fraud. Such incidents fell in a much narrower range of approximately 4-6 years old as compared to 4-9 in the past. This may indicate that the SEC is opting to pursue these incidents sooner and streamlining the process through which they are addressed.

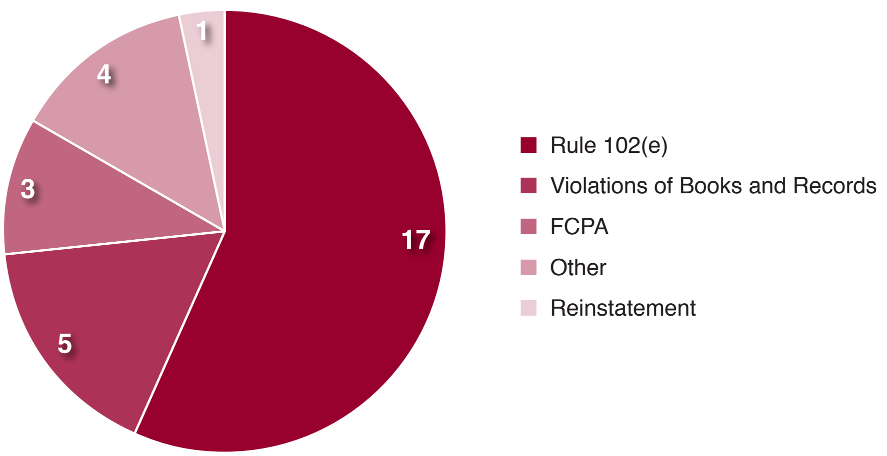
[8] Ensign, R. "Prosecutors: U.S. Firm Won't Face FCPA Liability in Overseas Deal." Wall Street Journal 14 Nov. 2014. Web. Dec. 16, 2014.

Overview of Q4 2014 AAERs

As part of our annual report on AAER activity, we provide an abbreviated version of our quarterly reporting for the final quarter of the year. The SEC reported 30 AAERs in Q4 2014, consistent with the results of annual information presented earlier.

Rule 102(e) violations dominated the releases in Q4, accounting for over half of the volume. Note that none of the AAERs in the recent quarter were attributed to the Financial Reporting Fraud category, something we haven't encountered before in our four years of AAER analysis.

Q4 2014 AAERs by Category



AAERs by Category for the Quarter Ended December 31, 2014:

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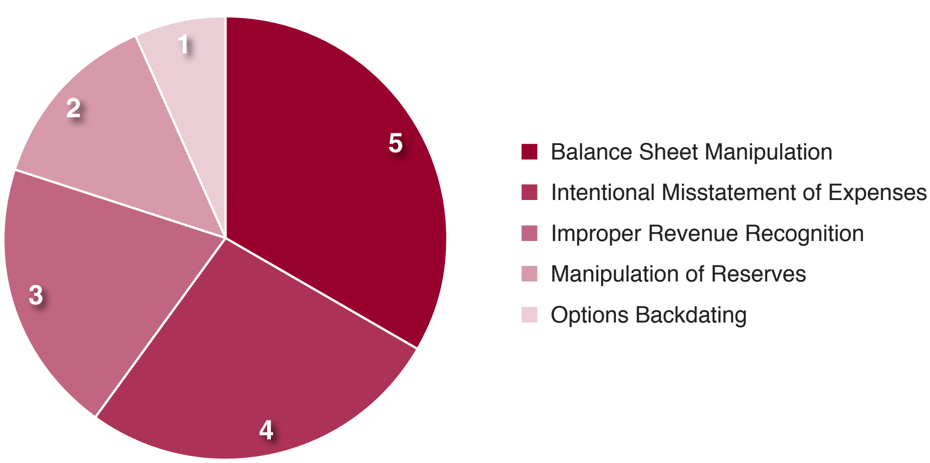
Also consistent with the 2014 annual results, balance sheet manipulation led all other issues in Q4 2014, accounting for 33.33% of the identified issues.

Financial Reporting Issues Identified in Q4 AAERs



Q4 2014 "Recommended Reading" AAER

While reviewing all of the SEC's AAERs would prove insightful, certain releases present information that is especially worthy of further review and analysis by those involved with financial reporting matters. We deem these particular releases as earning the distinction of "recommended reading" for our clients.

The AAER regarding Hampton Roads Bankshares, Inc ("HBRS") offers a case study on the sensitivity of judgments when forming assertions on tax matters to be presented in financial statements. While the determination of deferred tax assets ("DTAs") and liabilities may at times seem straightforward, the assessment of the realizability of a company's DTAs often requires significant judgment.

"Audit committees play a critical role in providing oversight over, and serving as a check and balance on, a company's financial reporting system."

James Schnurr
Chief Accountant
Office of the Chief Accountant
Washington, D.C.
Dec. 8, 2014

Remarks Before the 2014 AICPA National Conference on Current SEC and PCAOB Developments

Administrative Proceeding File No. 3-16296. In the Matter of Hampton Roads Bankshares, Inc., Respondent

HRBS is a bank holding company for Bank of Hampton Roads and Shore Bank and provides community and commercial banking services to individuals and small-to-medium sized businesses throughout Virginia, Maryland, and North Carolina. In December 2008, HRBS acquired all outstanding shares of Gateway Financial Holdings, Inc. ("Gateway"), which increased HRBS's assets from approximately $1 billion to approximately $3.1 billion. The SEC stated that during 2009, the performance of HRBS's loan portfolio, which included loans acquired primarily from Gateway, was deteriorating and leading to substantial losses. According to the release, the company historically carried a very small DTA balance. However, the DTAs on the company's books increased significantly in 2008, 2009, and the first quarter of 2010, almost entirely as a result of substantial loan loss reserves being recorded each quarter (none of which were tax deductible at the time). In essence, the DTAs recorded represented the future benefits the company would receive when it recorded these loan losses on future tax returns.

Through 2009 and the first quarter of 2010, HRBS recorded these DTAs without recording an offsetting valuation allowance, thereby concluding that its DTAs were fully realizable. According to the release, HRBS concluded that based on anticipated future earnings, the company was "more likely than not" to realize its DTAs within the applicable carryforward period. The SEC alleged that during November 2009, the former Executive Vice President and former Chief Financial Officer ("former CFO") conducted an analysis that focused on justifying the amount of DTAs the company carried on the books, and concluded that no valuation allowance was required to be recorded. This analysis allegedly involved assumptions that were based in part on projections forecasting loan performance through the end of 2010. Per the SEC, these analyses anticipated that the company would work through existing non-performing loans in 24-36 months and would earn a consistent $8.4 million in quarterly pre-tax, pre-provision income or $33.6 million annually.

In March 2010, the company prepared an updated analysis of the valuation allowance for 2009 year end. The company retained an outside consultant to provide limited assistance in directing the company to the appropriate accounting guidance. The SEC notes that this consultant did not provide an opinion on the validity of HRBS's conclusions, and relied on projections and assumptions provided by the company. Their analysis concluded that HRBS was *more likely than not*[9] to earn the $8 million future taxable income per year necessary to fully utilize the DTAs over the applicable carryforward period. According to the SEC, the memorandum acknowledged the severity of the current losses, but stated that the company did not expect losses to continue past 2011. The SEC alleged that the content of a new valuation allowance memorandum, dated May 2010, remained largely the same as the March 2010 analysis, despite the fact that the company's internal management projections showed substantial losses through 2011.

From December 2009 to July 2010, the company provided the SEC's Division of Corporate Finance and Office of the Chief Accountant with materials regarding its determination that a valuation allowance was not required on its DTAs. The SEC ultimately deemed the company's conclusions to be unreasonable based on the ongoing deterioration of HRBS's loan portfolio, as well as HRBS's internal financial projections of future losses. The SEC further noted that company's loan losses in 2009 had exceeded the aggregate taxable income for the prior three years and were continuing to grow. As a result of these inconsistent and overly optimistic projections, the SEC took the position that the former CFO should have known that the conclusions with regard to the need for a valuation allowance were not reasonable.

In August of 2010, HRBS restated its financial statements for year end 2009 and for the first quarter of 2010 to record a full valuation allowance on the DTAs. As a result, the company's reported DTA values went from $56.4 million to $397,000 for the year ended 2009 and from $70.3 million to $0 for Q1 2010. Under the Tier 1 capital calculation, a measure of a bank's financial strength, these restatements led the company to drop from "adequately capitalized" as of December 31, 2009 to "undercapitalized" as of March 31, 2010. The SEC concluded that HRBS violated the reporting, books and records, and internal controls provisions of the Exchange Act. The company was ordered to pay a fine of $200,000. The former CFO, who resigned from the company earlier and settled with the SEC in relation to the same allegations, was issued a cease-and-desist order and ordered to pay a penalty to the SEC in the amount of $25,000.

Valuation allowances for DTAs are often considered one of the more judgmental areas of accounting, as they typically involve an analysis of forward looking financial projections. ASC 740: Tax Provisions, requires an analysis of future taxable income when assessing the need for valuation allowances. As with any sensitive accounting judgment involving forward looking information, management should ensure any analysis of future taxable income is consistent with other contemporaneous internal financial projections, and is based on supportable assumptions.

In the case of HRBS, the alleged lapses in management's accounting judgments not only resulted in a restatement of prior financial statements, but also caused a significant change in certain regulatory classifications that are considered by investors and other interested parties.

"From time to time, the staff reviews restatement data to understand current trends and potential practice issues. One observation that we felt warranted further understanding was that while the total number of restatements over the past five years has been relatively consistent, restatements due to errors in the statement of cash flows continue to increase year over year."

T. Kirk Crews
Professional Accounting Fellow
Office of the Chief Accountant
Washington, D.C.
Dec. 8, 2014

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[9]The term *more likely than not* can be found within the tax guidance on uncertain tax positions and means a likelihood of more than 50 percent.

SEC NEWS: SPECIAL ANNOUNCEMENTS AND UPDATES

During the quarter ended December 31, 2014 the SEC announced several newsworthy items including the major developments described below.

SEC Proposes Amendments to Implement JOBS Act Mandate for Exchange Act Registration Requirements

Washington D.C., Dec. 18, 2014 —

As mandated by the Jumpstart Our Business Startups Act (JOBS Act), the SEC has approved the issuance of proposed amendments to revise the rules related to the thresholds for registration, termination of registration, and suspension of reporting under Section 12(g) of the Exchange Act.

The Commission voted on a proposal that would implement the mandate of the JOBS Act by:

- Amending Exchange Act Rules 12g-1 through 4 and 12h-3 which govern the procedures relating to registration, termination of registration under Section 12(g), and suspension of reporting obligations under Section 15(d) to reflect the new thresholds established by the JOBS Act
- Revising the rules so that savings and loan holding companies are treated in a similar manner to banks and bank holding companies for the purposes of registration, termination of registration, or suspension of their Exchange Act reporting obligations
- Applying the definition of "accredited investor" in Securities Act Rule 501(a) to determinations as to which record holders are accredited investors for purposes of Exchange Act Section 12(g)(1). The accredited investor determination would be made as of the last day of the fiscal year.

The proposal also would amend the definition of "held of record" to provide that when determining whether an issuer is required to register a class of equity securities with the Commission under the Exchange Act Section 12(g)(1), an issuer may exclude securities:

- Held by persons who received them under an employee compensation plan in transactions exempt from the registration requirements of Section 5 of the Securities Act or that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act
- In certain circumstances, held by persons who received them in exchange for securities received under an employee compensation plan

The Commission also is proposing a non-exclusive safe harbor under which a person will be deemed to have received the securities under an employee compensation plan if the person received them under a compensatory benefit plan in transactions that met the conditions of Securities Act Rule 701(c).

The JOBS Act revised Exchange Act Section 12(g) to raise the threshold at which an issuer is required to register a class of equity securities. Under the revised threshold, an issuer that is not a bank or bank holding company is required to register a class of equity securities under the Exchange Act if it has more than $10 million of total assets and the securities are "held of record" by either 2,000 persons, or 500 persons who are not accredited investors. An issuer that is a bank or bank holding company is required to register a class of equity securities if it has more than $10 million of total assets and the securities are "held of record" by 2,000 or more persons.

In addition, the JOBS Act raised the threshold at which a bank or a bank holding company may terminate or suspend the registration of a class of securities under the Exchange Act from 300 to 1,200 persons. The JOBS Act also directed the Commission to revise the definition of "held of record" to exclude securities held by persons who received the securities under an "employee compensation plan" in transactions exempted from the registration requirements of Section 5 of the Securities Act and to create a safe harbor that issuers can follow when making that determination.

The SEC will seek public comment on the proposed rule amendments for 60 days following their publication in the Federal Register. ■

SEC Adopts Rules to Improve Systems Compliance and IntegrityRules to Strengthen Technology Infrastructure of Securities Markets

Washington D.C., Nov. 19, 2014 —

The SEC voted to adopt new rules designed to strengthen the technology infrastructure of the U.S. securities markets. The rules—together comprising Regulation Systems Compliance and Integrity (Regulation SCI)—impose requirements on certain key market participants intended to reduce the occurrence of systems issues and improve resiliency when systems problems do occur.

"The rules adopted today mark an historic shift in the Commission's regulation of the U.S. securities markets that will better protect investors by requiring comprehensive new controls for the technological systems that form the core of our current markets," said SEC Chair Mary Jo White. "The rules provide greater accountability for those responsible for our critical market systems, helping ensure that such systems operate effectively and that any issues are promptly corrected and communicated to market participants and the Commission."

Given the heavy reliance on technology and automated systems in the securities markets today, the impact of technology failures can be significant. Recent technology issues in the markets have illustrated the risks of systems issues, including the impact on investors and losses that can occur.

Under Regulation SCI, self-regulatory organizations, certain alternative trading systems (ATSs), plan processors, and certain exempt clearing agencies will be required to have comprehensive policies and procedures in place for their technological systems. The rules also provide a framework for these entities to, among other things, take appropriate corrective action when systems issues occur; provide notifications and reports to the SEC regarding systems problems and systems changes; inform members and participants about systems issues; conduct business continuity testing; and conduct annual reviews of their automated systems.

The new rules become effective 60 days after publication in the Federal Register. Entities subject to Regulation SCI generally must comply with the requirements nine months after the effective date. ATSs newly meeting the volume thresholds in the rules for the first time, will be provided an additional six months from the time that the ATS first meets the applicable thresholds to comply. Further, entities will have 21 months from the effective date to comply with the industry- or sector-wide coordinated testing requirement. ■

SEC Staff Releases Accounting Bulletin to Update Guidance on Pushdown Accounting

Washington D.C., Nov. 18, 2014 —

The SEC's Office of the Chief Accountant and Division of Corporation Finance released a Staff Accounting Bulletin (SAB) to rescind portions of the interpretive guidance included in its SAB Series for what's known as pushdown accounting.

In order to reflect private sector developments in U.S. Generally Accepted Accounting Principles, the SEC's Staff Accounting Bulletin No. 115 rescinds SAB Topic 5.J. entitled *New Basis of Accounting Required in Certain Circumstances*. The new bulletin brings existing guidance into conformity with Accounting Standards Update No. 2014-17—*Business Combinations (Topic 805): Pushdown Accounting, a consensus of the FASB Emerging Issues Task Force*, which was ratified by the Financial Accounting Standards Board (FASB) on Oct 8, 2014.

The statements in SABs are not rules or interpretations of the Commission nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. ■

FACT SHEET

Prior Guidance

- SAB Topic 5.J was issued on Nov. 3, 1983, and expressed the staff's views regarding the application of the "push down" basis of accounting in the separate financial statements of entities acquired in purchase transactions.
- SAB Topic 5.J indicated that when a purchase transaction results in an entity becoming substantially wholly owned, a new basis of accounting should be established in the acquired entity's financial statements to reflect the acquirer's basis in the purchased assets and liabilities.

New Guidance

- The guidance in ASU No. 2014-17 provides an option to apply pushdown accounting in the separate financial statements of an acquired entity upon the occurrence of an event in which an acquirer obtains control of the acquired entity.

Impact

- ASU No. 2014-17 impacts the stand-alone financial statements of an acquired entity (subsidiary), however it does not change the requirement for an acquirer (parent) to apply business combination accounting and record its new basis in the acquired entity's assets, liabilities, and non-controlling interests in the acquirer's consolidated financial statements.
- The change will facilitate the financial community's transition to the new guidance by providing timely communication of the staff's views with regards to the continuing applicability of its historical interpretive guidance on pushdown accounting.

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ABOUT Floyd Advisory
Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of Business Strategy, Valuation, SEC Reporting, and Transaction Analysis.

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