BCLP. Client Intelligent

BCLPSecCorpGov.com

PUBLIC COMPANIES BEWARE OF SEC'S CONTINUING INTEREST IN ACCOUNTING AND DISCLOSURE CASES

Jun 22, 2020

As the end of the quarter approaches for most public companies, it is important to keep in mind that the SEC's Enforcement Division has brought numerous cases alleging financial and disclosure fraud in the past year. Many of the cases stem from efforts to meet analysts' earnings expectations by recognizing revenue prematurely or underreporting expenses and reserves. Some of the notable matters include:

- a case against a technology company alleging that it accelerated sales originally scheduled for future quarters, thereby masking declining market conditions,
- a case against a large insurance company alleging that it underreported reserves, and
- a case against a publicly traded REIT, alleging that it improperly adjusted "same property net operating income," a non-GAAP metric.

Allegations in some of the other cases involved:

- recognizing revenue when there were undisclosed side agreements enabling distributors to return product, or when getting paid was conditioned on the distributor's sale to an end user,
- inflating the value of a portfolio of complex reverse mortgage bonds, and
- failing to correct an error in accounting for FX losses.

The cases are usually accompanied by allegations of books and records violations and significant deficiencies in internal controls. The SEC almost always imposes multi-million dollar penalties on the companies and brings charges against the individuals the SEC deems responsible for the misstatements, which usually includes CEOs, CFOs and Controllers.

Financial reporting involves judgment calls that can be difficult to make. It is important that the company's motivation is accuracy and transparency in financial reporting, and not a desire to meet analyst's expectations, to mask declining demand or otherwise to present results that are more favorable than they really are. It is also important, if one discovers that errors or misstatements

have been made in the past, to address them promptly and properly. The company that discovered the error in accounting for FX losses attempted to “bleed them in over time” instead of correcting the error all at once. Conversely, when another company discovered that it had failed to record expense accruals and misclassified certain income to come closer to meeting consensus estimates, it restated its financial statements, disclosed the misconduct and self-reported to the Commission. In light of its extensive cooperation, the SEC did not impose a penalty on the company.

RELATED PRACTICE AREAS

- Securities & Corporate Governance

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.

© 2024 Bryan Cave Leighton Paisner LLP.