



*Summary of Accounting and
Auditing Enforcement Releases
for the Year Ended
December 31, 2022*

ANNUAL REPORT 2022

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Introduction and Our Objective

We are pleased to present you with our summary of the U.S. Securities and Exchange Commission’s (“SEC,” “Commission”) Division of Enforcement’s Accounting and Auditing Enforcement Releases (“AAERs”) for the quarter and calendar year ended December 31, 2022.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding financial reporting matters that will assist our clients in today’s fast-paced and demanding market. This report is just one example of how we continue to fulfill this commitment.

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

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

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

Floyd Advisory
JANUARY 2023

Highlights:

- The SEC released a total of 88 AAERs in calendar year 2022, a 13% increase from calendar year 2021, marking a reversal of the downward trend observed each year between 2018 and 2021.
- Consistent with calendar years 2020 and 2021, the leading financial reporting issue observed across all AAERs in calendar year 2022 was “failure to comply with SEC rules,” with 67 instances. This category includes making misrepresentations to auditors and investors, failing to comply with PCAOB audit standards, and making improper or incomplete disclosures.
- In 2022, the number of SEC AAERs related specifically to audits and auditors decreased by 27% compared to 2021, while the number of PCAOB auditing-related enforcement and disciplinary actions nearly doubled in 2022 compared to 2021.
- Q4 2022 included the only FCPA violation issued by the SEC this calendar year. A company was fined more than \$120 million in criminal monetary penalties, disgorgement, and prejudgment interest for payments offered and paid to foreign officials to secure certain contracts.
- In our Recommended Reading section, we highlight a Violations of Books and Records release in which a cannabis company’s transparency and cooperation helped it avoid monetary penalties despite having material accounting errors in its financial statements.

OUR PROCESS AND METHODOLOGY

The AAERs issued by the SEC are defined as financial reporting-related enforcement actions concerning civil lawsuits brought in federal court and notices and orders concerning the institution and/or settlement of administrative proceedings. The AAERs are intended to highlight certain actions and are not meant to be a complete and exhaustive compilation of all actions that may fit into the definition above.

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

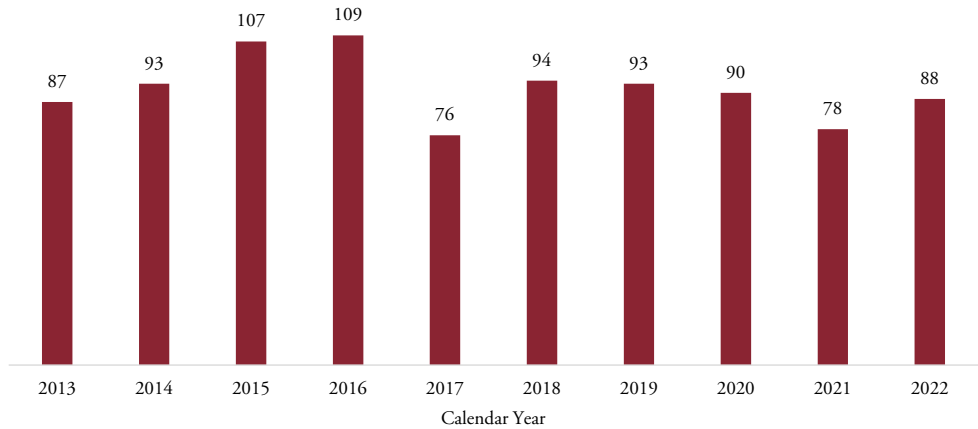
As part of our review, we gathered information and key facts, identified common attributes, and noted trends. Applying our professional judgment to the information provided by the SEC, we sorted the releases into major categories (i.e., Rule 102(e) Actions, Violations of Books and Records, Financial Reporting Fraud, Reinstatements to Appear and Practice before the SEC, Foreign Corrupt Practices Act (“FCPA”) Violations, and Other¹). When a release included more than one allegation, admission, or violation, we categorized the release by the most significant issue. Based on this process and methodology, we prepared a database of the key facts contained in each release.

¹ AAERs categorized as “Other” are generally related to certain logistical aspects of SEC proceedings, such as orders regarding scheduling, decision extensions, and entries of final judgments.

AAERs for the Twelve Months Ended December 31, 2022: Major Observations and Insights

For the twelve months ended December 31, 2022, the SEC issued 88 AAERs, representing an increase of 13% from last year.

Looking Back at Total AAERs in Preceding 10 Years

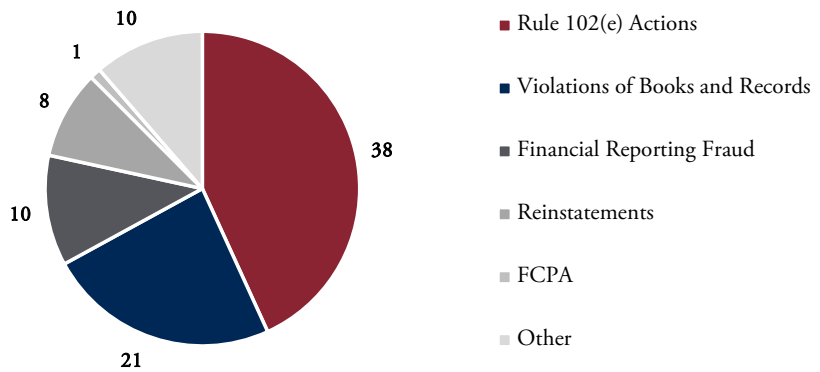


“With respect to penalties and remedies, simply put, they must be adequate to both punish and deter wrongdoing. ... Market participants must realize that complying with securities laws is cheaper than violating those laws.”

Gurbir S. Grewal,
 Director, Division of Enforcement
 November 15, 2022
 Remarks at Securities Enforcement
 Forum

To evaluate the type of enforcement action within each AAER issued in 2022, we categorized the releases into six major categories: Rule 102(e) Actions, Financial Reporting Fraud, FCPA, Reinstatements, Violations of Books and Records, and Other. The chart below illustrates the number of AAERs in each of these categories in 2022.

2022 AAERs by Category



Of significance, 43% of the actions brought forth by the SEC in 2022 related to Rule 102(e) Actions, consistent with prior year trends. Rule 102(e) authorizes the SEC to issue temporary or permanent suspensions or disbarments of professionals from practicing before the SEC. In addition, as it relates to an entity, the SEC can also order censures or limitations on activities under Rule 102(e).

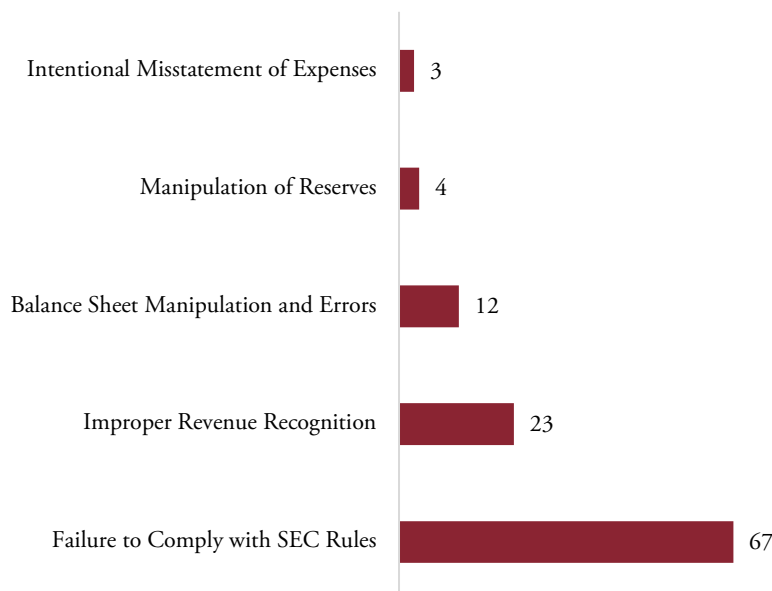
Summary of Financial Reporting Issues

To report on the frequency of financial reporting issues in the calendar year 2022 AAERs, we identified the specific accounting issue(s) related to each based on the classification definitions below.

Classification	Definition
Manipulation of Reserves	Improperly created, maintained, or released reserves and other falsified accruals
Improper Revenue Recognition	Overstated, premature, and fabricated revenue transactions reported in public filings
Intentional Misstatement of Expenses	Deceptive misclassifications and misstatements of expenses
Failure to Comply with SEC Rules	SEC filing offenses and financial disclosure errors, omissions, or otherwise misleading representations
Balance Sheet Manipulation and Errors	Misstatement and misrepresentation of asset balances and the recording of transactions inconsistent with their substance

Failure to comply with SEC rules represented the most common financial reporting issue in the 2022 AAERs, consistent with 2021. As part of our analysis, we tracked each accounting issue identified in a release as a separate item. Therefore, many actions that involved improper revenue recognition, manipulation of reserves, and the intentional misstatement of expenses also had a balance sheet impact. Likewise, some AAERs did not consist of financial reporting issues, rather, they acknowledged the reinstatement of suspended professionals and provided updates to earlier releases such as information on proceedings and hearings. AAERs not pertaining to financial reporting issues totaled 10 in 2022 and are excluded from the table below.

Financial Reporting Issues Identified in 2022 AAERs



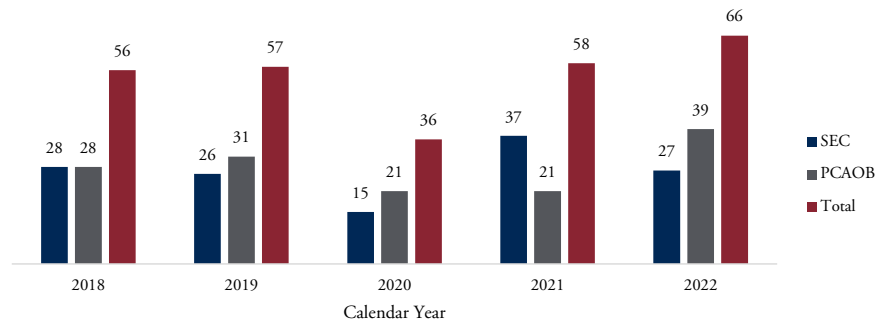
“Fraud is fraud, regardless of the investors being defrauded and the types of securities used in the fraud.”

Chair Gary Gensler,
November 15, 2022
“Good Counsellors”: Remarks
Before the Investment Adviser/
Investment Company National
Seminar: Compliance Outreach
Program

SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions

The SEC and PCAOB share the responsibility of enforcing disciplinary actions against auditors who violate SEC rules and professional standards. In 2022, auditing-related enforcement actions brought by the SEC decreased by 27%, while the number of PCAOB auditing-related enforcement and disciplinary actions nearly doubled. The total number of auditing-related enforcement actions brought by the SEC and PCAOB increased by 14% from 2021 and has generally trended upwards year-over-year, with the exception of a drop in 2020.²

SEC and PCAOB Auditing-Related Enforcement and Disciplinary Actions



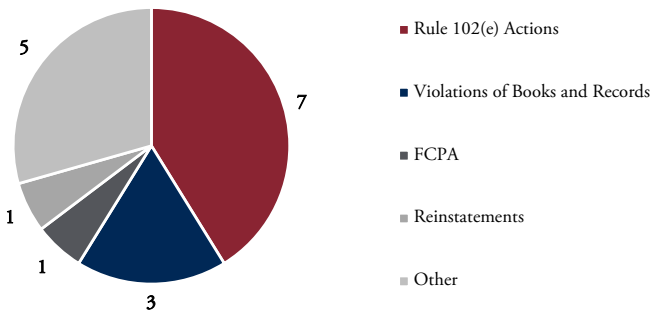
“PCAOB inspections consistently identify areas of concern involving auditors’ application of due professional care and professional skepticism when considering fraud or where the audit response to fraud risks and red flags was insufficient.”

Paul Munter,
Acting Chief Accountant
October 11, 2022
The Auditor’s Responsibility for
Fraud Detection

The Q4 2022 AAERs: Summary by Category and Insights from the Releases

In Q4 2022, the SEC issued 17 AAERs, including an FCPA violation for the first time this calendar year. Rule 102(e) Actions were the most prevalent, consistent with all other quarters this year, and representing nearly half of the total releases this quarter. The following graph further illustrates the total AAERs for Q4 2022 by category:

Q4 2022 AAERs by Category



² PCAOB figures for calendar years 2018 and 2019 have been updated from prior annual reports to include “termination of bars” enforcement actions. This type of enforcement disbars an individual from being an associated person of a registered public accounting firm as a result of certain actions taken (or not taken) during an audit.

Rule 102(e) Actions

Seven AAERs related to Rule 102(e) Actions were released during the quarter. As previously mentioned, Rule 102(e) Actions involve the temporary or permanent censure and denial of the privilege of appearing or practicing before the SEC.

Examples of the releases reported in this quarter's Rule 102(e) Actions include the following:

- The SEC ordered a public hearing to review evidence against a CPA that failed to conduct an audit in accordance with PCAOB standards.*** According to the release, a CPA failed to comply with multiple PCAOB standards in his role as the lead engagement partner for the audit of a toy company that materially misstated its tax-related valuation allowance and its tax expenses. The valuation allowance calculated by the company contained a \$129 million error that was discovered by the engagement manager just days before the company's Q3 2017 earnings release. In Q1 2018, the company identified a second error that ultimately reduced the total error amount to \$109 million. The release alleges that the audit team's workpapers did not include any mention of the error, a materiality analysis of the error, or associated internal control deficiencies related to the error. Additionally, the CPA did not inform the audit committee of the known error and ultimately approved the issuance of the Q3 2017 interim review workpapers, the 2017 audit report, and also issued clean opinions on the company's internal controls for fiscal years 2017 and 2018. According to the release, the CPA failed to comply with interim review standards, properly assess the risk of material misstatement, collect proper audit evidence, prepare proper audit documentation, and exercise due care. Additionally, he engaged in prohibited human resource services for the client that violated independence standards, including ranking candidates for management positions. As a result, in late 2019, the company restated its Q3 and Q4 2017 financial statements.
- The SEC suspended a Chartered Financial Analyst ("CFA") for issuing materially false and misleading company press releases and improperly recognizing revenue for fake and backdated orders.*** According to the original complaint, a CFA directed a technology company and its former subsidiary to issue materially false and misleading press releases from January 2019 to November 2020, touting agreements and relationships with customers that did not exist or were exaggerated. The CFA allegedly falsified the books and records of the subsidiary for the second and third quarters of its 2020 fiscal year by creating fake and backdated orders, resulting in improper revenue recognition. During that period, the subsidiary raised approximately \$30 million from investors under false representations and warranties that the financial statements were prepared in accordance with GAAP. The CFA was suspended from appearing or practicing before the Commission as an accountant and is eligible to apply for reinstatement in five years.
- The SEC temporarily suspended a CPA for fraudulently raising funds for personal use.*** As alleged in the original SEC complaint, a CPA and the real estate company where he served as president, fraudulently raised \$14.5 million from EB-5 Program investors by issuing false and materially misleading statements describing the use of the funds.³ The CPA and the company informed the investors that their funds would be used to develop property through the United States Citizenship and Immigration Services' Employment-Based Immigration Fifth Preference Program, and would allow them to obtain permanent residency in the United States. According to the release, the CPA used the funds to engage in personal stock trading, satisfy margin calls, pay the company's operating expenses, make lease payments on his luxury car, and fund other related businesses that he owned.

³ EB-5 Program investors are eligible to apply for a Green Card if they make the necessary investment in a commercial enterprise in the United States and plan to create or preserve 10 permanent full-time jobs for qualified United States workers. See <https://www.uscis.gov/working-in-the-united-states/permanent-workers/eb-5-immigrant-investor-program>

"Recent Commission enforcement actions against audit firms and their personnel continue to highlight instances of improper professional conduct by auditors with respect to fraud risks. In these enforcement actions, the Commission alleged that auditors failed to comply with PCAOB standards by, among other things, ignoring red flags and contradictory information and failing to obtain sufficient and appropriate audit evidence."

Paul Munter,
Acting Chief Accountant
October 11, 2022
The Auditor's Responsibility for
Fraud Detection

The CPA was temporarily suspended in November 2022 from appearing or practicing before the Commission. The temporary nature of the suspension is pending response from the CPA and a hearing before the SEC.

Violations of Books and Records

This quarter we categorized three AAERs as Violations of Books and Records, a category that includes alleged improper accounting treatments and internal control problems deemed worthy of an enforcement action but not meriting financial reporting fraud.

A summary of one of the Violations of Books and Records releases this quarter is outlined below and a second is highlighted in our Recommended Reading section.

- ***The SEC imposed a cease-and-desist order against a chemicals company for making materially misleading statements about its debt reduction efforts.*** The release alleges that in 2018, a chemicals company issued a press release announcing a plan to reduce its debt by \$80 million over the next year. Throughout 2019, the company regularly reported its net debt and net leverage ratios, two non-GAAP financial measures, in earnings calls and press releases, emphasizing its debt reduction efforts. At year-end, the company announced that its debt reduction goal had been reached but failed to mention in the release that it had reached its goal by delaying material overdue payments to vendors. At the end of fiscal year 2019, according to the release, the company delayed a payment of \$72 million in vendor invoices, more than 85% of its debt reduction goal. The company paid these invoices the week after the reporting period ended through a drawdown of its revolving line of credit, effectively reversing most of the reported reduction. As it failed to disclose the practices around reaching its debt reduction goal, the company was ordered to pay a civil money penalty of \$1.3 million for issuing materially misleading public statements.

FCPA

There was one FCPA-related release in Q4 2022, resulting in more than \$120 million in criminal monetary penalties, disgorgement, and prejudgment interest. Below is a summary of the release within this category:

- ***A manufacturing company violated the anti-bribery, books and records, and internal accounting provisions of the FCPA through bribery schemes in Brazil and Algeria.*** According to the release, a manufacturing company's U.S. wholly-owned subsidiary in Brazil offered as much as \$4 million to a Brazilian official to win a contract with the Brazilian state-controlled oil company. Additionally, a different business unit of the company allegedly paid money to an Algerian government official to secure a contract amendment with the Algerian state-owned oil company. The release states that the company did not maintain accurate books and records related to these activities and lacked sufficient internal controls to detect and prevent the misconduct. The company cooperated with the Commission's investigation and implemented several remedial efforts including terminating all employees involved in the illegal activities and improving the company's internal controls. The company received a criminal fine of \$39.6 million (after providing a 50% offset for payments made to Brazilian authorities) as part of the subsidiary's resolution with the United States Department of Justice concerning the conduct in Brazil. Separately, the SEC ordered the company to pay disgorgement and prejudgment interest totaling \$81.2 million, subject to an offset of up to \$38.7 million based on the U.S. dollar value of any amounts paid in a parallel proceeding in Brazil.

"Make no mistake: If a company or executive misstates or omits information material to securities investors, whether in an earnings call, on social media, or in a press release, we will pursue them for violating the securities laws."

Chair Gary Gensler,
November 2, 2022
"This Law and Its Effective
Administration": Remarks Before
the Practising Law Institute's 54th
Annual Institute on Securities
Regulation

Reinstatement

There was one release in Q4 2022 related to the reinstatement of an accountant to practice before the SEC. The following is a summary of this release:

- ***The SEC reinstated a Chartered Accountant to appear and practice before the Commission.*** According to the original 2016 release, the individual served as the assistant controller and general manager of finance for an information technology services company. The accountant allegedly accepted embezzled cash from a company accountant from 2006 through 2009, violated the firm’s conflict of interest policy, and failed to correct known erroneous entries within the company’s intercompany accounts and Exchange Rate Fluctuation. As a result, the individual was suspended from practicing before the Commission as an accountant for four years, at which point he would be considered for reinstatement. He complied with the terms of his suspension and was reinstated with the requirement that his work will be reviewed by the independent audit committee of any company he works for in the future. The release indicates that the individual is not currently seeking to appear or practice before the Commission as an independent accountant.

Notable Q4 2022 AAER for “Recommended Reading”

While reviewing all the SEC’s AAERs would prove insightful, certain releases present information that is especially worthy of further review and analysis by those involved with financial reporting matters. We deem these particular releases as earning the distinction of “Recommended Reading” for our clients. This quarter, we chose to highlight a release in which transparency and cooperation spared a company from monetary penalties despite having material accounting errors in its financial statements.

Accounting and Auditing Enforcement Release No. 4357 / October 24, 2022, In the Matter of Cronos Group Inc.

Why Transparency and Cooperation Matter

Growing Pains

The SEC published a Violations of Books and Records AAER this quarter related to a newly public cannabis company, Cronos Group Inc. (“Cronos” or the “Company”). The matter arose out of material accounting errors that existed in the Company’s financial statements for three quarters from 2019 through 2021.

Cronos became a publicly traded issuer in 2019 and had an immediate focus on business expansion and entering new markets. The Company, however, lacked knowledge of applicable accounting requirements as well as adequate internal accounting controls to prepare financial reports in accordance with reporting requirements. As a result, the Company issued materially misstated financial statements in three quarters during its first few years as a public company. Unfortunately, this could have been avoided if the appropriate accounting personnel had been employed and the appropriate internal accounting controls had been established at the Company.

Below is a brief overview of Cronos’ business, how the problem arose, the contracts and related material accounting errors that existed, and importantly, how transparency and cooperation helped this Company avoid costly fines and penalties.

“Effective internal controls over financial reporting contribute to reliable financial statements.”

Commissioner Hester M. Peirce,
October 7, 2022
Sus and Yeet: Remarks before the
University of California Irvine Audit
Committee Summit

Overview of Cronos' Business

Cronos was incorporated in the Province of British Columbia and is headquartered in Toronto, Ontario. The Company engages in the cultivation, manufacturing, and marketing of cannabis and other cannabis-derived products. In 2020, Cronos began reporting as a U.S. domestic issuer, and as such, began preparing its financial statements in accordance with generally accepted accounting principles ("GAAP"). Prior to that, in 2018 and 2019, Cronos qualified as a foreign private issuer with the SEC, requiring it to prepare its financial statements in accordance with International Financial Reporting Standards ("IFRS").

How the Problem Arose

In 2019, the Company's business was primarily focused on the cultivation and growth of cannabis flowers (hereafter, "flowers") to sell to the retail market. During this time, the Company suffered an insect infestation in its storage facilities and the majority of the flowers became unsuitable for sale, with only lower quality inventory remaining. Separately, the Company was focused on its new endeavor: a cannabis vaporizer, which it believed would eventually surpass the flower market.

To enter the cannabis vaporizer market, Cronos needed cannabis resin (hereafter, "resin"). Resin is a substance that is naturally produced in the cannabis plant and contains many of the active compounds that cannabis is known for, including tetrahydrocannabinol ("THC"), the primary psychoactive component of the cannabis plant, and the key input for cannabis vaporizer cartridges. Even if the Company's flowers were of higher quality, it lacked the manufacturing capabilities to convert its flowers into resin. As a result, the Company entered into contracts with two different companies to procure resin in 2019.

Contracts and Material Accounting Errors

Under the first contract, in the first and third quarters of 2019, Cronos sold the lower quality flowers to Company A and received resin (derived from higher quality flowers) in return for nearly the same dollar amount. IFRS requires a company to assess whether recognizing revenue from a sale and simultaneous purchase is appropriate. To recognize revenue, IFRS requires that the sale related to the contract have "commercial substance." In other words, the sale must change the Company's future cash flows. Cronos' sale of the flowers and simultaneous purchase of resin for nearly the same dollar amount lacked commercial substance. Ultimately, Cronos improperly recognized 35% and 16% of gross revenue in these quarters and restated its financial statements.

Separately, in the third quarter of 2019, under the second contract, Company B procured high quality flowers, converted it to resin, and sold it to Cronos. The Company could recognize revenue related to the contract when it sold the vaporizer cartridge that held the resin.

During this time, Cronos was facing a shortfall of projected third quarter revenue and asked Company B to buy its low-quality flowers. These sales would be considered routine sales transactions and unrelated to the contract. Company B knew Cronos' goal was to increase revenue in the period and agreed to buy the flowers if Cronos purchased the derivative product back from Company B in the following quarter, which the CFO at the time verbally agreed to do. The CFO did not in fact have the authority to make this agreement and did not disclose this verbal agreement to anyone else.

Cronos ultimately recognized \$2.3 million in revenue related to the sale of its low-quality flowers, but because of the round-trip nature of cash flows, this transaction, again, lacked commercial substance, as the Company's cash flows were not expected to change because of the transaction. As a result, Cronos improperly recognized 22% of gross revenue during the third quarter of 2019 and corrected the error in its restated financial statements.

"Upon discovering material accounting errors, Cronos promptly self-reported and cooperated with our investigation. We charged the company and a former insider for the violation, but we did not impose a penalty. This should send a message: If you mess up—and people do mess up sometimes—come in and talk to us, cooperate with our investigation, and remediate your misconduct."

Chair Gary Gensler,
November 2, 2022

"This Law and Its Effective Administration": Remarks Before the Practising Law Institute's 54th Annual Institute on Securities Regulation

Additionally, in the third quarter of 2019, Cronos acquired a manufacturing and distributing business that was recorded on its books as an indefinite-lived intangible asset of \$64 million plus goodwill of \$214 million. In 2020, Cronos transitioned from IFRS to GAAP reporting standards, which required it to test goodwill and indefinite-lived intangible assets for impairment at least once a year.

In the second quarter of 2021, Cronos personnel became aware of information indicating an impairment to the carrying value of this recently acquired business, however, the accounting personnel lacked a sufficient understanding of GAAP and, among other things, only considered positive aspects of the business and neglected to consider negative factors in their impairment analysis, such as lower revenue and profits compared to projected results. By the third quarter of 2021, Cronos determined that 80% of intangible assets and 99% of goodwill was impaired. As a result, Cronos restated its financial statements for the second quarter of 2021.

Transparency and Cooperation

Cronos restated its financial statements for each of the three quarters that had material accounting misstatements. According to the release, although Cronos admitted that it lacked accounting personnel with adequate knowledge of both IFRS and GAAP reporting requirements, the SEC did not impose a civil penalty against the Company, recognizing its transparency and cooperation, including the following:

- Each time Cronos became aware of the material accounting errors in its financial statements, it self-reported to the SEC at the onset of its internal investigation;
- Throughout its internal investigations, Cronos provided the SEC timely updates and voluntarily produced documents and other materials related to the material accounting errors; and
- Upon learning of its material accounting errors, Cronos developed and implemented new internal accounting controls, developed a training program related to accounting matters, and hired staff that had the appropriate knowledge of GAAP requirements.

Cronos also agreed to hire an independent consultant to review and evaluate the aforementioned remediation efforts, among other items, within a 120-day period and report their findings to the SEC.

During the 2022 calendar year, the SEC imposed more than \$709 million in penalties across 46 AAERs. In ten of these AAERs, the SEC considered the organization's self-remediation efforts, transparency, and cooperation when determining the penalty amount. In three additional AAERs, including the one related to Cronos, the SEC did not impose a penalty and specifically cited the entity's self-remediation efforts, transparency, and cooperation as the reasons.

Employing adequately trained accounting personnel and establishing strong internal controls over financial reporting are essential to avoiding costly fines and penalties. However, should an organization find itself in a situation where a restatement or internal investigation is necessary, being transparent and cooperative throughout is a best practice, as demonstrated in this release.

www.floydadvisory.com

ACKNOWLEDGEMENT

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For more information, please contact LeeAnn Manning at 617.586.1076 or Marni Kaufman at 617.586.1072.

ABOUT Floyd Advisory

Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of SEC reporting, transaction advisory, investigations and compliance, litigation services, as well as business strategy and valuation.

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