Dissenting Statement In the Matter of Lynn R. Blodgett and Kevin R. Kyser, CPA, Respondents

Commissioner Luis A. Aguilar

Aug. 28, 2014

During my tenure, I have been a strong supporter of the SEC's Enforcement program. I have advocated for an effective Enforcement program by focusing on individual accountability, effective sanctions that deter and punish egregious misconduct, and policies designed to eradicate recidivism.[1] The importance of a strong and robust Enforcement program cannot be overstated. It is a vital component of an effective capital market on which investors can rely. Much of the agency's enforcement decisions are to be commended. However, I am obligated to speak out when it appears that the agency falters.

Accordingly, I respectfully dissent from the Commission's Order accepting the settlement offer of Kevin R. Kyser, a Certified Public Accountant and former Chief Financial Officer ("CFO") of Affiliated Computer Services, Inc. ("ACS" or "Company").

Given the egregious conduct that Mr. Kyser engaged in at ACS, the Commission's settlement, which lacks fraud charges or a timeout in the form of a Rule 102(e) suspension, is a wrist slap at best.

First, let's discuss the improper accounting at issue here. As the Commission's Order[2] states, ACS violated generally accepted accounting principles ("GAAP") by inserting itself into pre-existing sales transactions between a manufacturer and a reseller for the primary purpose of booking revenues from those transactions.[3] Thus, the Company's involvement in those transactions had no economic substance.[4] ACS's misconduct enabled it to improperly report approximately $125 million in revenues, [5] and, crucially, gave the misleading impression that it had met its internal revenue growth guidance. [6] ACS failed to disclose the true nature of these improper transactions,[7] and falsely reported its internal revenue growth in public filings.[8]

Second, let's discuss how Mr. Kyser, in his critical role as CFO, facilitated ACS's misconduct. As described in the Commission's own Order, Mr. Kyser:

- Understood that ACS had inserted itself into these pre-existing transactions and that they would impact ACS's reported revenue growth;[9]
- Was responsible for the content of ACS's false and misleading public filings with the Commission, earnings releases, and analyst conference calls;[10]
- Highlighted ACS's false and misleading internal revenue growth in earnings releases and analyst conference calls;[11]
- Failed to ensure that ACS adequately disclosed and described the significance of these transactions in ACS's public filings and analyst conference calls;[12]
- Signed false certifications in connection with the Company's periodic filings;[13] and
- Received an inflated bonus based on ACS's financial performance that was overstated by 43%. [14]

Accountants—especially CPAs—serve as gatekeepers in our securities markets. They play an important role in maintaining investor confidence and fostering fair and efficient markets. When they serve as officers of public companies, they take on an even greater responsibility by virtue of holding a position of public trust. To this end, when these accountants engage in fraudulent misconduct, the Commission *must* be willing to charge fraud and *must* not hesitate to suspend the accountant from appearing or practicing before the Commission. This is true regardless of whether the fraudulent misconduct involves *scienter*.

The Commission instead chose to charge Mr. Kyser with limited, narrow non-fraud charges, comprising of violations of the books and records, internal controls, reporting, and certification provisions of the federal securities laws. In the past, respondents with the same state of mind and similar type of misconduct as Mr. Kyser have been charged with violations of the antifraud provisions of the Securities Act, in particular, Sections 17(a)(2) and/or (3), as well as the books and record and internal control violations.[15]

In addition, where CPAs engage in this type of egregious securities fraud—especially misconduct that relates to the CPAs' core expertise of financial reporting—the Commission has rightly required such persons to forfeit their privilege to appear and practice before the Commission by imposing a suspension under Rule 102(e) of the Commission's Rules of Practice.[16]

Beyond this particular matter, I am concerned that the Commission is entering into a practice of accepting settlements without appropriately charging fraud and imposing Rule 102(e) suspensions against accountants in financial reporting and disclosure cases. I am also concerned that this reflects a lack of conviction to charge what the facts warrant and to bring appropriate remedies.

The statistics on financial reporting and disclosure cases and related Rule 102(e) suspensions reflect a troubling trend. In fiscal year 2010, the Commission brought 117 financial reporting and disclosure cases against issuers and individuals, and imposed Rule 102(e) suspensions in 54% of those cases.[17] In 2011, the number of financial reporting and disclosure cases against issuers and individuals brought by the Commission fell to 86, and the Commission imposed Rule 102(e) suspensions in 53% of those cases.[18] In 2012, again the number of similar cases brought by the Commission fell, this time to 76, and the Commission imposed Rule 102(e) suspensions in 49% of those cases.[19] In 2013, the Commission brought only 68 similar cases, and imposed Rule 102(e) suspensions in only 41% of those cases.[20] These declining numbers reveal a departure from the Commission's efforts to keep bad apples out of the securities industry, and this puts investors and the integrity of the Commission's processes at grave risk.

In my six years as a Commissioner, I have watched defendants fight charging decisions on all fronts, including fighting tooth-and-nail to avoid being suspended from appearing or practicing before the Commission pursuant to Rule 102(e). This is to be expected, as a suspension order takes a fraudster out of the industry, and often has a far more lasting impact on the fraudster than the imposition of a monetary fine.[21]

A Rule 102(e) suspension is an appropriate sanction to be imposed when people choose to engage in deception and perpetuate fraud—in other words, when people engage in flagrant, harmful misconduct. Thus, to avoid sanctions under Rule 102(e), defendants strenuously object to scienter-based and non-scienter-based fraud charges[22] (as opposed to lesser charges, such as books and records or internal control violations). That is to be expected.

What is not to be expected is when defendants engage in fraud and the Commission affirmatively accepts a weak settlement with lesser charges. This leaves the investing public significantly at risk, as bad actors are not appropriately charged or sanctioned and are permitted to continue to operate in the securities industry. This is completely unacceptable.

I am concerned that this case is emblematic of a broader trend at the Commission where fraud charges—particularly non-scienter fraud charges—are warranted, but instead are downgraded to books and records and internal control charges. This practice often results in individuals who willingly engaged in fraudulent misconduct retaining their ability to appear and practice before the Commission.

I fear that cases in the future will continue to be weak. More specifically, I fear that when the staff determines not to seek a Rule 102(e) suspension, it will also forgo bringing fraud charges. Likewise, I am concerned that Commission Orders may, at times, be purposely vague and/or incomplete, and written in a way so as to lead the public to conclude that no fraud had occurred. When this happens, the public is denied a full accounting and appreciation of the egregious nature of a defendant's misconduct. In addition, this practice muzzles my voice by not allowing any statement by me (including this dissent) to include a fulsome description of facts that support the view that the Commission should have brought fraud charges.[23] This adversely impacts my ability as a Commissioner to provide the American public honest and transparent information—including a description of facts discovered by the staff during its investigation. In the end, these behind-the-curtain decisions can make fraudulent behavior appear to be an honest mistake.

In my view, Mr. Kyser's egregious misconduct violated, at a minimum, the non-scienter-based antifraud provisions of the Securities Act. Accordingly, charges under Sections 17(a)(2) and/or (3) are warranted and a Rule 102(e) suspension is necessary and appropriate in this case.

The Commission must send a strong and consistent message to the industry that the Commission takes seriously its responsibility of requiring integrity in the financial markets. For these reasons, I dissent.

[1] *See,* for example, Commissioner Luis A. Aguilar: *A Stronger Enforcement Program to Enhance Investor Protection* (Oct. 25, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370540071677; *Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws* (Oct. 18, 2012), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171491510; *Combating Securities Fraud at Home and Abroad"* (May 28, 2009), *available at* http://www.sec.gov/news/speech/2009/spch052809laa.htm; *Reinvigorating the Enforcement Program to Restore Investor Confidence* (Mar. 18, 2009), *available at* http://www.sec.gov/news/speech/2009/spch031809laa.htm; *Empowering the Markets Watchdog to Effect Real Results* (Jan. 10, 2009), *available at* http://www.sec.gov/news/speech/2009/spch011009laa.htm.

[2] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Securities Exchange Act of 1934 Release No. 72938, Accounting and Auditing Enforcement Release No. 3578, Administrative Proceeding File No. 3-16045 (Aug. 28, 2014) (hereinafter "Order"), *available at* http://www.sec.gov/litigation/admin/2014/34-72938.pdf.

[3] "At or near the end of each quarter ended September 30, 2008 through the quarter ended June 30, 2009, Affiliated Computer Services ("ACS") arranged for an equipment manufacturer to re-direct through its pre-existing orders through ACS, which gave the appearance that ACS was involved." Order at p. 2. "ACS improperly applied GAAP in determining the amount of revenue to report in each of its quarters in FY 2009. In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the 'resale transactions' under GAAP." Order at p. 4. *See also* SEC Press Release, "SEC Charges Two Information Technology Executives With Mischaracterizing Resale Transactions to Increase Revenue" (Aug. 28, 2014) (hereinafter "Press Release"), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542786775 ("The Securities and Exchange Commission today charged two executives at a Dallas-based information technology company with mischaracterizing an arrangement with an equipment manufacturer to purport that it was conducting so-called "resale transactions" to inflate the company's reported revenue.").

[4] "ACS, however, had no substantive involvement in the orders, and there were no changes to the terms of the pre-existing orders." Order at p. 2. "In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the 'resale transactions' under GAAP." Order at p. 4.

[5] "ACS improperly reported approximately $125 million in revenue due to such arrangements." Order at p. 2. "In total, ACS reported revenue of $124.5 million from such arrangements during fiscal 2009. … In making a determination of the amount of revenue to report, ACS did not appropriately take into account all of the critical terms of the arrangement and therefore failed to reflect the lack of economic substance of the 'resale transactions' under GAAP. In addition, ACS's internal controls were insufficient to provide reasonable assurance that ACS reported revenues in conformity with GAAP, primarily because ACS failed to appropriately evaluate the economic substance of the 'resale transactions.'" Order at p. 4.

[6] "The revenue from these 'resale transactions' enabled ACS to meet its publicly disclosed internal revenue growth ("IRG") guidance for three of the four quarters for that fiscal year." Order at p. 4.

[7] "Even though the 'resale transactions' were the largest contributors to ACS's internal revenue growth, ACS did not disclose them in its September 30, 2008 Form 10-Q. In subsequent quarters, ACS disclosed these transactions as 'information technology outsourcing related to deliveries of hardware and software.' This description did not accurately disclose the nature of these transactions, and falsely suggested that they were executed as part of existing ACS outsourcing contracts." Order at p. 4.

[8] "As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period." Order at p. 2.

[9] "Blodgett and Kyser understood the origination of these 'resale transactions' and their impact on ACS's reported revenue growth." Order at p. 5. *See also* Press Release, *supra* note 3 ("ACS positioned itself in the middle of pre-existing transactions without adding value, but still improperly reported the revenue. Blodgett and Kyser knew the truth about these deals, and they were responsible for ensuring that ACS accurately disclosed the full story to investors.") (*quoting* David R. Woodcock, Director of the SEC's Fort Worth Regional Office and Chair of the SEC's Financial Reporting and Audit Task Force).

[10] "During all relevant periods, Respondents Blodgett and Kyser were, respectively, ACS's chief executive officer and chief financial officer. As such, they were responsible for the content of ACS's filings with the Commission, as well as ACS's earnings releases and analyst conference calls." Order at p. 2.

[11] "As a result, ACS falsely reported its internal revenue growth, which Blodgett and Kyser highlighted in earnings releases and analyst conference calls during the period." Order at p. 2.

[12] "Blodgett and Kyser understood the origination of these 'resale transactions' and their impact on ACS's reported revenue growth. However, Blodgett and Kyser did not ensure that ACS adequately described their significance in ACS's public filings and on analyst calls." Order at p. 5.

[13] "Blodgett and Kyser certified each of ACS's fiscal year 2009 Forms 10-Q and 10-K." Order at p. 5.

[14] "As a result of the improperly reported revenue, Blodgett and Kyser received bonuses based on fiscal 2009 performance that were 43% higher than they would have received if ACS had properly applied GAAP with respect to determining the amount of revenue to report from the resale transactions." Order at p. 5.

[15] It has long been held that the second and third subsections of Section 17(a) of the Securities Act, Sections 17(a)(2) and (3), can be satisfied by proof of negligence, rather than scienter as is necessary for Section 17(a)(1) of the Securities Act. *See Aaron v. SEC*, 446 U.S. 680, 697 (1980) (stating that "It is our view, in sum, that the language of §17 (a) requires scienter under § 17 (a)(1), but not under § 17

(a)(2) or § 17 (a)(3).”). For examples of accountants found to have negligently violated the federal securities laws and charged with violations of Securities Act Sections 17(a)(2) and (3), *see e.g., In the Matter of Fifth Third Bank and Daniel Poston,* Securities Act Release No. 9490 (Dec. 4, 2013) (Misclassification of loans; imposing a Rule 102(e) suspension on a CFO in a matter in which the individual was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2013/33-9490.pdf*; In the Matter of Craig On (CPA)*, Exchange Act Release No. 66051 (Dec. 23, 2011) (Understated loan losses; imposing a Rule 102(e) suspension on a CFO in a matter in which the individual was charged with, among other things, violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2011/34-66051.pdf; *In the Matter of Larry E. Hulse, CPA*, Exchange Act Release No. 62589 (July 29, 2010) (Improper reserve adjustments; imposing a Rule 102(e) suspension on Sunrise Senior Living, Inc.’s CFO in a matter in which the individual was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2010/34-62589.pdf; *In the Matter of Lawrence Collins, CPA*, Exchange Act Release No. 64808 (July 5, 2011) (Improper revenue reporting; imposing a Rule 102(e) suspension in a matter in which a finance division employee was charged with violations of Sections 17(a)(2) and (3) of the Securities Act), *available at* http://www.sec.gov/litigation/admin/2011/34-64808.pdf; *In the Matter of Gregory Pasko, CPA*, Exchange Act Release No. 61149 (Dec. 10, 2009) (Earnings management; imposing a Rule 102(e) suspension on the Director of External Reporting at SafeNet, Inc. after he was charged with non-scienter-based violations of the antifraud (Sections 17(a)(2) and (3) of the Securities Act), books and records and internal controls violations of the federal securities laws), *available at* http://www.sec.gov/litigation/admin/2009/34-61149.pdf.

[16] *Id.* Indeed, in the last five years, there is only one case where the Commission did not obtain a suspension against a CPA/CFO who was subject to an antifraud injunction. *See SEC v. John Michael Kelly et al.*, Lit. Rel. No. 22109 (Sept. 29, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr22109.htm. In that matter, the Commission agreed to a settlement with Mr. Kelly permanently enjoining him from violations of the non-scienter antifraud provisions of the federal securities laws (Securities Act Sections 17(a)(2) and (3)), but did not impose a Rule 102(e) suspension against him. In my view, agreeing to that settlement was an abdication of the Commission’s responsibility to police the financial reporting system and maintain the integrity of the securities markets. Thus, I dissented in that case.

[17] Select SEC and Market Data, Fiscal 2010, at 11, *available at* http://www.sec.gov/about/secstats2010.pdf.

[18] Select SEC and Market Data, Fiscal 2011, at 16, *available at* http://www.sec.gov/about/secstats2011.pdf.

[19] Select SEC and Market Data, Fiscal 2012, at 14, *available at* http://www.sec.gov/about/secstats2012.pdf.

[20] Select SEC and Market Data, Fiscal 2013, at 13, *available at* http://www.sec.gov/about/secstats2013.pdf.

[21] *See*, Jayne W. Barnard, *When Is a Corporate Executive "Substantially Unfit to Serve?"* 70 N.C.L. Rev. 1489, 1522 (1992).

[22] For the same reasons, defendants who are accountants have also been known to object to charges under Exchange Act Section 13(b)(5) (knowingly circumventing or failing to implement internal controls or knowingly falsifying records) and/or Exchange Act Rule 13b2-2 (lying to auditors).

[23] Facts and information discovered by the investigative staff in the course of an investigation that are not described in a Commission Order or other public document are deemed confidential and, therefore, SEC representatives are prohibited from revealing to the public such non-public information that are not made a matter of the public record. *See, e.g.,* 17 C.F.R. Section 230.122, which provides

that "[e]xcept as provided by 17 C.F.R. 203.2, officers and employees are hereby prohibited from making … confidential [examination and investigation] information or documents or any other non-public records of the Commission available to anyone other than a member, officer or employee of the Commission, unless the Commission or the General Counsel, pursuant to delegated authority, authorizes the disclosure of such information or the production of such documents as not being contrary to the public interest."

Last modified: Aug. 28, 2014