

Report Improper Revenue Recognition and Qualify for an SEC Whistleblower Award

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On September 7, 2017, the SEC announced that financial services firm State Street agreed to pay [more than \\$35 million](#) to settle charges that it fraudulently charged secret mark-ups for transition management services. According to the SEC's [order](#), the scheme generated approximately \$20 million in improper revenue for the firm. After a client discovered the overbilling scheme, State Street attempted to cover it up by blaming it on a "fat finger error." The SEC determined that this statement was a misrepresentation as the mark-ups were done intentionally.

SEC Whistleblower Program

Under the SEC Whistleblower Program, whistleblowers are eligible to receive an award for providing the SEC with original information about a violation of the federal securities laws, including improper revenue recognition. If the SEC uses a whistleblower's information to bring a successful enforcement action, the whistleblower is eligible to receive 10% to 30% of the monetary sanctions collected as an award. Thus, if whistleblowers had tipped the SEC about State Street's overbilling scheme, they could be eligible to receive an award of up to \$10.5 million.

The SEC Whistleblower Program also [protects the confidentiality of whistleblowers](#) and does not disclose information that might directly or indirectly reveal a whistleblower's identity. Moreover, whistleblowers can submit an [anonymous tip](#) to the SEC if represented by an attorney. Importantly, [even compliance personnel, auditors \(external and internal\), accountants, officers and directors may be eligible to receive awards under the program](#).

SEC Whistleblower Awards

Since 2011, the SEC has paid [more than \\$158 million to whistleblowers](#). In fact, one tip about [accounting violations that improperly inflated revenue by \\$80 million](#) has already resulted in a [\\$22 million SEC award](#). The largest award to date is [more than \\$30 million](#). These tips from whistleblowers have lead the SEC to successful enforcements actions resulting in more than [\\$1 billion in financial remedies](#).

SEC Takes Aim at Improper Revenue Recognition

According to a [Report Pursuant to Section 704 of the Sarbanes-Oxley Act of 2002](#), during the five years preceding the enactment of SOX, the “SEC brought the greatest number of actions [involving issuer financial-report violations] in the area of improper revenue recognition: 126 of the 227 enforcement matters involved such conduct, including the **fraudulent reporting of fictitious sales, improper timing of revenue recognition, and improper valuation of revenue.**” Years later, the SEC continues to focus on issuer reporting and disclosure violations, especially improper revenue recognition, as the violations remain widespread at publicly traded companies.

According to the SEC’s [2016 Annual Report to Congress on the SEC Whistleblower Program](#), a majority of whistleblowers tips submitted to the SEC Whistleblower Program relate to violations with corporate disclosures and financials:

- In 2013, there was 557 corporate disclosures and financials tips;
- In 2014, there was 610 corporate disclosures and financials tips;
- In 2015, there was 687 corporate disclosures and financials tips; and
- In 2016, there was 938 corporate disclosures and financials tips.

Moreover, a [2016 Harvard article](#) finds that the most common SEC enforcement actions concerning accounting violations are related to “inaccurate representations of revenue.”

SEC Enforcement Actions for Improper Revenue Recognition

The following SEC enforcement actions are examples of the types of improper revenue recognition schemes that could result in an SEC whistleblower award:

Fraudulent Overbilling Schemes

- *SEC v. Garthright*: The SEC charged SMF Energy Corp. and its officers with accounting fraud for [inflating revenues through a fraudulent billing scheme](#). According to the SEC’s complaint, the billing scheme “increased the amount of gallons of fuel invoiced beyond what was actually delivered to customers,” which resulted in false and misleading disclosures in the company’s SEC filings. The billing scheme circumvented SMF Energy’s internal accounting controls and led to, among other things, materially overstated revenues, profit margins, shareholders’ equity, and net income in its SEC filings. The scheme resulted in several SEC violations, including the failure to maintain a system of internal controls sufficient to ensure that its customers were charged in accordance with their respective contracts, the failure to record revenues and liabilities in accordance with GAAP, and the failure to design (or to cause others to design) disclosure controls and procedures that would have caused the company to disclose and report that it recognized revenue from improper charges to customers. The SEC disgorged all ill-gotten profits and proceeds received as a result of the actions.
- *SEC v. MedQuist, Inc.*: The SEC charged MedQuist with accounting fraud when it [secretly](#)

[inflated customer bills by increasing the number of lines of medical test that it purportedly transcribed](#). According to the SEC's complaint, the "scheme was able to continue for several years because the unit of measure upon which bills to many customers were based . . . could not be verified by customers. Knowing that its customers were unable to verify line counts on bills, [MedQuist] . . . manipulate[d] line counts on customer bills to reach specific revenue and margin targets." MedQuist and its Director, President, and Chief Operating Officer were charged with violating securities laws.

Improper Timing of Revenue Recognition

- *SEC v. L3 Technologies, Inc.*: The SEC charged L3 for failing to maintain accurate books and records and failing to maintain adequate internal controls when the company [improperly recorded \\$17.9M in revenue from a contract by creating invoices associated with unresolved claims](#) that were not delivered when the revenue was recorded. According to the SEC's order, employees "immediately reported concerns regarding potential violations of L3's accounting policies and internal accounting controls to L3's internal ethics department," but the subsequent ethics review failed to uncover the misconduct due, in part, to "a failure by ethics investigators to adequately understand the billing process."
- *SEC v. Dickson*: The SEC charged IGI Inc. with fraudulent accounting practices and reporting, inadequate internal controls, and books-and-records violations for engaging in [fraudulent sales-cutoff practices and other improper accounting practices](#). As a result of the improper sales-cutoff practices, "IGI misstated its assets, revenues, and net income" for several years.

Fictitious Sales

- *SEC v. Putnam*: The SEC charged Anicom Inc. and its directors with violating federal securities laws after the company [falsely reported millions of dollars of nonexistent sales](#) to inflate net income by more than \$20M. According to the SEC's complaint, Anicom included in its financial statements millions of dollars in sales to a fictitious customer, SCL Integration.