SEC ANNOUNCES CHARGES AGAINST FULTON FINANCIAL CORPORATION AND INTERFACE, INC., IN BELLWETHER OF INCREASED EARNINGS MANAGEMENT ENFORCEMENT ACTIVITY

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On September 28, the SEC announced charges against two public companies, Interface, Inc. (“Interface”) and Fulton Financial Corporation (“Fulton”), for violations related to the reporting of improperly calculated earnings per share (“EPS”) that enabled the companies to meet or exceed consensus analyst estimates. In the case of Interface, charges were also levied against the company’s former Chief Financial Officer (“CFO”) and Chief Accounting Officer (“CAO”) for directing subordinates to book unsupported, manual accounting entries that did not comply with generally accepted accounting principles (“GAAP”). These enforcement actions are a result of the implementation of an “EPS Initiative” by the Division of Enforcement that seeks to leverage risk-based data analytics to identify potential instances of accounting and disclosure violations, including those resulting from earnings management practices.

The SEC focused on accounting entries recorded on Interface’s books during the period from the second quarter of 2015 through the second quarter of 2016. The SEC alleged that Interface reported financial results that did not accurately reflect the company’s actual performance, and, instead, inflated income and EPS figures to show consistent earnings growth. The alleged misstatements were found to be materially misleading because the earnings reported in two quarters enabled the company to meet consensus analyst EPS estimates when, had the unsupported accounting entries not been made, the company would have delivered results below analyst estimates. The SEC alleged that a lack of adequate internal controls over financial reporting created an environment in which the CFO and CAO (then-Corporate Controller) were able to direct subordinates to make the improper adjustments to Interface’s financial records. Interface settled the charges against it by agreeing to pay a $5 million civil penalty to the SEC. The former CFO, Patrick C. Lynch, agreed to pay a civil penalty of $70,000 and was suspended from serving as an accountant of a public company for one year, subject to a favorable ruling for reinstatement following his suspension. Gregory J. Bauer, Interface’s former CAO, agreed to pay a civil penalty of $45,000 and was similarly suspended from serving as an accountant of a public company for three years.

In its case against Fulton, the SEC alleged that the company “made material misrepresentations and omissions in its public filings and failed to maintain accurate books and records and sufficient internal accounting controls.” The SEC found Fulton’s financial reporting to be materially misleading because the company’s accounting treatment of its “mortgage servicing rights” differed from the impairment valuation methodology disclosed in its 2016 Form 10-K. The misstatements effectively increased Fulton’s EPS in a quarter where the company would otherwise have missed consensus estimates. Fulton agreed to pay a $1.5 million civil penalty in settlement of the charges against it.

The Interface and Fulton cases indicate the SEC, through its EPS Initiative, is placing particular emphasis on earnings management practices as a tool for manipulating EPS in order to meet “street” expectations. In the aforementioned cases, the SEC made clear that inadequate internal control environments and practices that differ from a company’s written accounting policies and procedures are actionable under the securities laws. Given these developments, we expect to see increased enforcement activity on EPS-related financial reporting issues in the near term.

For additional information, please feel free to call or email Therese Pritchard (202-508-6252 or tdpritchard@bclplaw.com), Ashley Ebersole (202-508-6105 or ashley.ebersole@bclplaw.com), Kwabena Yeboah (202-508-6083 or kwabena.yeboah@bclplaw.com) or any member of our Securities Litigation and Enforcement team.

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