

SEC Continues to Target Companies for Financial Reporting Failures

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At the very end of the year, [the SEC announced](#) the entry of an administrative order instituting cease-and-desist proceedings in connection with financial reporting at a major rental car company, including earnings guidance.

According to the order, “under persistent pressure to meet budgets, and to generate opportunities to help close company-wide budget gaps or revenue shortfalls,” the company did not comply with GAAP in 2012 in accounting for contingencies, particularly in determining when to increase the allowance for or the amount to write-off related to recovering money to offset expenses for vehicle damage. The methodology was changed several times in 2013 for determining the allowance or the amounts of aged debt to be written off, each assuming more favorable collection results than historical data reflected and with favorable impact to the company’s financial statements. Due in part to the lack of documentation to support some of the changes, the internal audit department declared an internal control deficiency by April 2013.

In the fourth quarter of 2013, the company extended the planned holding periods for a significant portion of its U.S. car fleet, some from 20 to 24 to 30 months, which spread out the depreciation expense the company had to incur on its cars over more months. The SEC determined that the company failed to adequately disclose this decision, and instead the second quarter Form 10-Q regarding the decline in depreciation expense, which tracked the disclosure from the first quarter, was inaccurate because it was silent about the extensions of holding periods and cited reasons for the decline that were not correct, including mix optimization and improved procurement and remarketing.

In addition, in September 2013 the Company revised its earnings guidance downward from what it had issued in February of the same year, from \$1.78 to \$1.88 per share to \$1.68 to \$1.78 per share, but contemporaneous internal analysis projected results at \$1.72 per share, which eventually decreased to \$1.65 a share. “Strenuous ‘gap-closing’ efforts ensued,” which led the company to decide that errors in the methodology had led to the changes in internal estimates, but nonetheless the company reaffirmed its guidance in November.

The company eventually restated its 2011, 2012 and 2013 financial statements and disclosed 11 material weaknesses.

Shortly after the SEC issued its order, the company issued an 8-K acknowledging the SEC settlement, noting that “all” board members and senior management “were replaced in the aftermath of the restatement.”

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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