

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 98297 / September 6, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21616

In the Matter of

KENT N. SMITH,

Respondent.

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

I.

The Securities and Exchange Commission (“Commission” or “SEC”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Kent N. Smith (“Smith” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over the Respondent and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this 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 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. This matter stems from Smith's involvement in Fluor Corporation's ("Fluor") percentage of completion ("POC") accounting for a fixed-price construction project on which Fluor served as the subcontractor and carried a risk of cost overruns with respect to work within the contract's scope.
2. The project required Fluor to validate and complete the design and to build a one-of-a-kind U.S Army facility for manufacturing nitrocellulose, an ammunition propellant, ("Radford" or the "Radford Project"). In 2015, Fluor submitted a bid on the Radford Project, relying on overly optimistic cost and timing estimates. Following the Radford Project's subcontract award, Fluor experienced cost overruns that worsened over time.
3. For the fiscal year ended December 31, 2017 and the first two quarters ended March 31 and June 30, 2018 ("Relevant Period"), Smith, the then-Senior Vice President within the Fluor Government Group ("FGG"), a segment of Fluor, accepted materially inaccurate financial estimates for Radford. Smith knew or should have known that these financial estimates caused materially overstated revenue to be recorded on Fluor's books and records and likewise that certain anticipated additional costs were improperly excluded. The result was that the overstated revenue kept the project forecast from a loss position. Further, in support of the foregoing, Smith helped generate, reviewed, and accepted documents required by Fluor's internal accounting controls, but which supported the incorrect revenue estimates and overstated revenue. Smith thereby was a cause of Fluor's failure to maintain a system of internal accounting controls sufficient to account for the Radford contract in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). These failings resulted in Fluor's maintaining inaccurate books and records and ultimately Fluor including materially misstated financial statements in periodic reports filed with the SEC for the fiscal year ended December 31, 2017 and the quarters ended March 31 and June 30, 2018. Smith was a cause of Fluor's filing these materially inaccurate financial statements in its periodic reports with the SEC.
4. In August 2019, Fluor announced \$714 million in pre-tax charges stemming from an "operational and strategic review" of sixteen projects, including Radford. Prompted by the SEC staff's investigation, Fluor undertook an internal investigation in 2020 that identified material weaknesses in its internal control over financial reporting and material errors in its financial statements and resulted in Fluor restating its annual and quarterly financial statements for its fiscal year 2016 through the third quarter of 2019, as disclosed in its 2019 Form 10-K filed with the SEC on September 25, 2020 (the "Restatement"). The material weaknesses identified in the Restatement were attributable in part to control failures associated with the Radford Project, which resulted in material errors. Throughout the Relevant Period, Fluor's accounting issues on the Radford Project resulted in materially overstated net earnings in Fluor's reported financial statements. Regarding the Radford Project, Fluor overstated its annual net earnings by \$38 million (25%) in 2017, understated its net loss by \$8.7 million (33%) in the first quarter ended March 31, 2018 and overstated its net earnings by \$7.5 million (10%) in the second quarter ended June 30, 2018.

5. As a result of conduct detailed herein, Smith was a cause of Fluor's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 thereunder.

Respondent

6. Kent N. Smith, age 63, is a resident of Dillon, Montana. He was Senior Vice President within FGG, and the head of the FGG subsidiary responsible for the Radford Project, from 2013 until July 2018, when he left the company. He has never been registered with the Commission in any capacity.

Relevant Entity

7. Fluor Corporation is a Delaware corporation with its principal place of business in Irving, Texas. Since registering its common stock with the SEC under Section 12(b) of the Exchange Act in 2000, Fluor has been required to file periodic reports on Forms 10-K and 10-Q with the SEC pursuant to Section 13(a) of the Exchange Act and related rules thereunder. During the Relevant Period, the stock traded on the New York Stock Exchange under the ticker symbol "FLR." Fluor performs engineering, procurement, and construction services worldwide and operates through business segments, including FGG.

Background

8. Under GAAP, Fluor accounted for its fixed-price projects using the POC method, whereby it was required to periodically recognize the project's costs as incurred and the revenue as a percentage of the work completed to date. Under this method, each reporting period, a project team develops dependable estimates of expected total revenues, total costs, and total project gross margin ("PGM") to arrive at the project's financial forecast (known as the Estimate at Completion or "EAC"). A project must recognize the entire amount of an anticipated loss as soon as the loss becomes evident.

9. To periodically record a project's EAC, Fluor required use of the Project Margin Analysis Report ("PMAR"), which should document project management's most likely current estimate of the project's revenue, cost, and PGM forecast. Fluor's internal accounting controls required that Smith, along with two other segment officers, provide sub-certifications to corporate-level management with each signer representing that "to the best of our knowledge and belief," the project forecasts represent management's best estimate, and are in compliance with the applicable GAAP and Fluor's policies, and also required that Smith sign the documentation supporting the accounting determinations for projects with significant risk.

Radford Project

10. In December 2015, Fluor finalized a \$245 million fixed-price subcontract with its customer ("Customer") for the Radford Project to validate and complete the design and to build the Radford Project. As part of the scope of work, Fluor was provided an incomplete design from the

prior, terminated subcontractor (“Prior Design”) that it was required to validate and complete when performing the subcontract.

11. Smith and other FGG executives were told during the bidding process that agreeing to validate and complete the facility’s design was risky because FGG personnel did not know the Prior Design’s quality or completeness. By early 2016, Smith, among other Fluor personnel, was aware that the incomplete and flawed Prior Design was causing significant additional cost and delay on the Radford Project.

12. During the Relevant Period, the difference between the subcontract price and the anticipated total cost of the Radford Project grew significantly as delays and cost overruns worsened. This growing anticipated total costs over the subcontract price should have prompted Fluor to revise the EAC to reflect all the additional anticipated costs. Instead, Smith participated in formulating guidance, with accounting and other FGG personnel, indicating that generally costs should be added to the EAC only to the extent that the costs are offset by corresponding additional forecasted revenues. This guidance did not comply with GAAP. During the Relevant Period, Smith was a cause of Fluor personnel excluding costs from the EAC, consistent with this erroneous guidance. As a result, Fluor’s forecasted cost in the EAC remained artificially low, which, when combined with Fluor forecasting revenue using overly high assumed rates of recovery, as described below, delayed recognition of a loss on the Radford Project.

13. To address the growing anticipated total cost over the original subcontract price, Smith and other Fluor personnel determined to develop and submit change orders, also known as Project Change Notices (“PCNs”). PCNs are proposed modifications of a contract that change the price or scope of work of the contract, or both. The subcontract prescribed a process for submitting PCNs in appropriate circumstances. Fluor submitted numerous PCNs on the Radford Project.

14. Through fiscal year-end 2017, Fluor was required to record revenue for unapproved PCNs under POC accounting in compliance with ASC Subtopic 605-35, *Construction-Type and Production-Type Contracts* (“ASC 605-35”), and could only record it if recovery of the additional revenue was deemed probable. Under ASC 605-35, a PCN should be evaluated as a “claim” if it was a change order in dispute, or unapproved as to both scope and price. Revenue recognition for a claim under ASC 605-35 required a heightened level of evidence to demonstrate probable recovery.

15. Smith supported the inclusion in the EAC of forecasted additional revenue from the unapproved PCNs, including rejected and not yet submitted PCNs, using overly high rates of assumed recovery on the PCN’s cost component. Fluor used an assumed recovery rate of 100% of the costs, a decision in which Smith participated, during the year ended December 31, 2017. The additional anticipated revenues from the PCNs offset corresponding forecasted costs and minimized the adverse impact on the PGM. Fluor assumed these incorrect recovery rates despite its actual rates of recovery from approved PCNs being low.

16. As part of the preparation of the 2017 year-end financial statements, Smith was involved in the preparation of documentation to support the recognition of revenue on the Radford Project under ASC 605-35, which was requested by Fluor financial personnel. This control activity's objective was to document the facts and analysis supporting revenue estimates on projects with significant risks and judgments in accordance with GAAP. The documentation Smith assisted in drafting and ultimately signed failed to support that Fluor was entitled to the PCN revenue or that recovery from the Customer was probable. This documentation, on which Fluor relied in reporting revenue on the Radford Project, stated that Fluor was entitled to payment because the Customer had misrepresented the status of the Prior Design prior to the execution of the subcontract. But, Smith should have recognized that it was not probable under GAAP that Fluor would recover money from the Customer to pay for the delays and design issues underlying the majority of PCNs at the assumed 100% recovery rate based on, among other considerations, his experiences dealing with the Customer on the Radford Project. Throughout the Relevant Period, the Customer had rejected many PCNs, blamed Fluor for the design problems, and maintained that Fluor was responsible for the additional costs under the terms of the existing fixed-price subcontract.

17. In concluding recovery of the PCNs was probable for purposes of including the PCN revenue in the forecast, this documentation relied on a summarized version of a one-on-one meeting between Smith and a Customer employee, who had recently assumed operational responsibilities for the Radford Project, stating that the Customer employee had "verbally acknowledged [Customer's] responsibility for these changes and agreed to reconsider all rejected change orders, as well as begin reviewing and negotiating all PCNs with Fluor in late February." Fluor financial personnel and others reviewing the documentation construed this to mean that the Customer was indicating that it would pay for the PCNs. This conversation, however, did not support the document's conclusion because the Customer employee had told Smith that the Customer would undertake a revamped process to assess PCNs, not that it would approve or pay for any individual PCN.

18. Smith also signed the sub-certification to Fluor's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") for the fiscal year ending December 31, 2017, representing "to the best of his knowledge and belief" that, among other things, the financial information was presented in conformity with GAAP, that change orders unapproved as to scope, price, or both, had been recorded in accordance with ASC 605-35, and that all project forecasts represented management's best estimate of Fluor's financial results, when he knew or should have known that the financial estimates caused materially overstated revenue to be recorded on Fluor's books and records and, likewise, that certain anticipated additional costs were improperly excluded.

19. In the first quarter of 2018, Fluor adopted ASC 606, *Revenue from Contracts with Customers* ("ASC 606"), which superseded the revenue recognition requirements in ASC 605. Under ASC 606, Fluor could only include the unapproved PCNs in the revenue forecast if Fluor had an enforceable contractual right to additional revenue beyond the fixed contract price, considering all relevant facts and circumstances, including the terms of the contract. For the first and second quarters of 2018, Fluor did not sufficiently evaluate under ASC 606 if it had an

enforceable contractual right to the unapproved PCNs. Without such an evaluation, it was improper to include revenue from the unapproved PCNs in its forecast for the two quarters ended March 31 and June 30, 2018. Even if Fluor had sufficiently evaluated under ASC 606 whether it had an enforceable contractual right to the unapproved, it was only permitted to increase forecast revenue to the extent it was probable that a significant reversal in the amount of cumulative revenue recognized would not occur, weighing factors such as the limited predictive value from Fluor's prior experience given the low recovery rates, the length of time it would take to resolve and susceptibility to the judgment of third-parties.

20. Fluor and Smith lacked sufficient evidence to support that recorded revenue arising from the unapproved PCNs would not be reversed. For example, through the time he left Fluor in July 2018, Smith continued to approve the inclusion of revenue from unapproved change orders in the project PMAR, even though the Customer continued to reject PCNs and had approved only monetarily small PCNs. Although the Customer continued to consider PCNs of greater monetary value, including most relating to the immaturity of the Prior Design, the Customer had already signaled it was less inclined to approve. As a result, Fluor failed to maintain a system of internal accounting controls sufficient to prepare an estimate that complied with GAAP.

21. During the quarter ended March 31, 2018, Fluor continued to use an assumed recovery rate of 100% on PCNs. During the second quarter ended June 30, 2018, Fluor used an assumed 90% recovery rate. The additional revenues from the PCNs offset additional forecasted costs and minimized the adverse impact on the PGM. Fluor assumed these overly optimistic recovery rates despite its actual rates of recovery from approved PCNs continuing to be low.

22. For the quarter ended March 31, 2018 and the quarter ended June 30, 2018, Smith continued to approve of the inclusion of revenue from the unapproved PCNs. Smith signed sub-certifications to Fluor's CEO and CFO for the first quarter of March 31, 2018, with the same attestations as the prior sub-certification, but under ASC 606.

23. The conduct described above resulted in inaccurate books and records in reporting periods from year-end 2017 through the second quarter of 2018. Smith was aware of information indicating that the Radford Project's EAC did not include all anticipated costs and that the assumed rate of recovery for the PCNs revenue was too high. Smith therefore was a cause of Fluor's improper inclusion of revenue for Radford unapproved PCNs in Fluor's periodic filings with the SEC, due to the incorrect recovery rates on PCNs, as described below:

Radford Project	4Q 2017	1Q 2018	2Q 2018
Unapproved PCNs in revenue forecast, net of profit fee	\$47M	\$68M	\$69M
Assumed recovery rate of net PCN revenue in revenue forecast	100%	100%	90%
Percent of total PCN revenue actually approved by Customer	4.5%	3.9%	3.4%

24. Smith also was a cause of Fluor's improper exclusion of anticipated costs resulting in inaccurate books and records during the Relevant Period. As a result of the errors described above, Fluor materially misstated its net earnings in periodic reports filed with the SEC as follows:

Reporting Period	Overstated Net Earnings	As % of Reported Net Earnings (Loss)
2017 (annual)	\$38.4 million	25%
Q1 2018	\$8.7 million	(33%)
Q2 2018	\$7.5 million	10%

Violations

25. As a result of the conduct described above, Smith was a cause of Fluor’s violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 thereunder. Section 13(a) of the Exchange Act requires issuers with a class of securities registered pursuant to Section 12 of the Exchange Act to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1 and 13a-13 require the filing of annual and quarterly reports, respectively. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.

26. As a result of the conduct described above, Smith was a cause of Fluor’s violations of Section 13(b)(2)(A) of the Exchange Act, which requires an issuer of a security registered pursuant to Section 12 of the Exchange Act to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the issuer’s transactions and disposition of assets.

27. As a result of the conduct described above, Smith was a cause of Fluor’s violations of Section 13(b)(2)(B) of the Exchange Act, which requires an issuer of a security registered pursuant to Section 12 of the Exchange Act to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: transactions are executed in accordance with management’s general and specific authorization; transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and to maintain accountability for assets; access to assets is permitted only in accordance with management’s general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

B. Respondent shall, within 10 business days of the entry of this Order, pay a civil money penalty in the amount of \$20,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Kent N. Smith as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Carolyn M. Welshhans, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the penalties referenced in paragraph B above. This Fair Fund may be combined with the Fair Fund created in *In the Matter of Fluor Corporation*, AP File No. 3-21610. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against

Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Vanessa A. Countryman
Secretary