

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 78711 / August 29, 2016

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3797 / August 29, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17510

In the Matter of
THOMAS DULEK, CPA,
Respondent.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 4C OF
THE SECURITIES EXCHANGE ACT
OF 1934 AND RULE 102(e) OF THE
COMMISSION’S RULES OF
PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against Thomas Dulek (“Respondent” or “Dulek”) pursuant to Section 4C¹ of the Securities Exchange Act of 1934 (“Exchange Act”), and Rule 102(e)(1)(ii)² of the Commission’s Rules of Practice.

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

² Rule 102(e)(1)(ii) provides, in pertinent part, that:

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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions (“Order”) as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds³ that:

A. SUMMARY

These proceedings arise out of Dulek’s improper professional conduct as the engagement partner of the fiscal year (“FY”) 2011 and 2012 audits of the financial statements of OCZ Technology Group, Inc. (“OCZ”), a now-bankrupt manufacturer and seller of computer memory storage and power supply devices. Dulek failed to conduct the audits in accordance with Public Company Accounting Oversight Board standards. The deviations from PCAOB standards related to the auditing of (a) purported customer marketing programs; (b) OCZ’s inventory valuation accounting; (c) year-end sales cut-off; and (d) sales return reserves in FY 2011.

B. RESPONDENT

Thomas Dulek is a certified public accountant in California where he has been licensed since 1994. Dulek was a partner at a PCAOB-registered public accounting firm from December 2008 through June 2012. Dulek was the engagement partner responsible for the FY 2011 and 2012 audits of OCZ.

C. RELEVANT ENTITY

OCZ Technology Group, Inc. was a Delaware corporation formed in 2002 that was headquartered in San Jose, California. As of April 2010, OCZ’s common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the NASDAQ Capital Market. OCZ’s common stock was de-listed from NASDAQ as of March 6, 2014. On April 16, 2015, the Commission issued an Order Instituting Proceedings, Making Findings and

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

³ 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.

Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934.

OCZ engaged in fraudulent financial reporting from at least FY 2011 through 2012. As a result of this fraud and other accounting errors, OCZ significantly overstated its revenues and gross profits in FY 2011 and 2012 (as well as in the first quarter of FY 2013).⁴ In October 2013, OCZ restated its financial statements, decreasing previously reported revenues and gross profits by over \$100 million from the second fiscal quarter of FY 2011 through the first fiscal quarter of 2013—a nearly 20% reduction in previously reported revenues and a significant reduction in previously reported gross profits.

Shortly after it filed restated financial statements, OCZ filed for bankruptcy protection and it has since liquidated its assets and is no longer operating. On October 6, 2015, the Commission filed a complaint against OCZ's former CEO alleging, among other things, that he engaged in a fraud to materially inflate OCZ's revenues and gross margins and violated the lying to accountants rule of the Exchange Act. The Commission separately charged OCZ's former chief financial officer for certain accounting, disclosure, and internal accounting controls failures at OCZ.⁵

D. FACTS

Background

1. Dulek was the engagement partner on the FY 2011 and 2012 audits of OCZ's financial statements. As the engagement partner, Dulek had overall responsibility for the conduct of the audits, including supervision of team members and compliance with PCAOB standards.
2. Dulek signed off on the FY 2011 and 2012 audits and caused the issuance of audit reports for those years containing an opinion that OCZ's financial statements were presented fairly, in all material respects, in conformity with generally accepted accounting principles ("GAAP"). The audit reports also stated that the audits were conducted in accordance with PCAOB standards.
3. OCZ's financial statements in FY 2011 and 2012, in fact, contained numerous departures from GAAP that resulted in the significant overstatement of the company's revenues and gross profits. Moreover, as outlined below, the audits were not conducted in accordance with PCAOB standards.

⁴ OCZ's fiscal year ended at the end of the month of February.

⁵ See Litigation Release No. 23379 (Oct. 6, 2015).

Failure to Audit OCZ's Customer Based Programs (CBPs) in Accordance with PCAOB Standards in FY 2011 and 2012

4. Historically, OCZ had provided customers with several types of sales discounts, which, consistent with GAAP, were reported as reductions to revenue. In addition to these programs, OCZ enacted a program called "customer based programs" or "CBPs." Pursuant to the program, OCZ would purportedly offer short-term marketing reimbursement programs to its customers. OCZ would pay for the purported marketing performed by customers by providing credits to its customers that they could apply to their account receivable balances ("CBP credits"). After enacting the program, OCZ began pushing its salespeople to provide CBPs to customers in lieu of other types of sales discounts. Customers rarely if ever performed marketing activities equal to the value of the credits they received and at times did not perform any marketing activities at all. Rather, CBPs were used as a mechanism through which OCZ provided sales discounts to customers, which should have been accounted for as revenue reductions, but were instead improperly recorded as marketing expenses. Accordingly, the CBP credits did not properly reduce OCZ's revenues and gross profits as they should have.

5. As part of its restatement, OCZ reclassified the CBP credits as reductions to revenues.

6. GAAP requires that consideration provided to a customer be recorded as a reduction of revenue unless two criteria are met: (1) the vendor receives an identifiable benefit for consideration that could have been obtained from a party other than the purchaser of its product; and (2) the vendor can reasonably estimate the fair value of the benefit. (*See* ASC 605-50-45). Dulek did not design adequate procedures for the engagement team to perform to obtain audit evidence to verify that either of these criteria was satisfied.

7. In FY 2011 and 2012, the engagement team's testing with respect to CBPs focused on whether OCZ had recorded sufficient liabilities to cover the CBP commitments it had made to customers. Dulek did not have the engagement team sufficiently test whether OCZ received an identifiable benefit from its customers or whether OCZ could reasonably estimate the value of any such benefit. For example, the engagement team did not confirm with any customers that marketing had actually been performed in exchange for CBP credits or the extent of any such marketing. Nor did the engagement team test the value of the marketing that OCZ purportedly received from customers in connection with any program to ensure that it equaled the value of the credit given to the customer. Thus, insufficient testing was performed to determine whether OCZ had properly characterized CBP credits as marketing expenses in its income statements.

8. The failure to perform adequate audit testing to determine whether OCZ was properly accounting for CBP credits as marketing expenses was unreasonable in light of the following risks relating to CBPs, among others, of which Dulek was or should have been aware:

- a. The audit work papers identified revenue as being a high risk area in 2011 and 2012.
- b. Revenues and gross margins were metrics about which OCZ management regularly put out guidance in documents filed with the Commission that were reviewed by Dulek. These metrics were directly affected by OCZ's classification of marketing and discount programs.
- c. Dulek drafted a June 2011 letter to OCZ's Board noting that OCZ had no written "accounting policies and methodology used in determining the sales and marketing programs accruals (and related income statement classification)." Dulek similarly reviewed a FY 2012 audit engagement team memo to OCZ questioning the controls in place to ensure that OCZ was properly accounting for sales programs, such as CBPs. In answering the question, management did not identify any specific controls to address the issue.

9. By not planning or performing appropriate audit procedures to determine that CBPs were properly accounted for in OCZ's income statements, Dulek violated AS No. 15.4, which requires that auditors "must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion."⁶

⁶ The provision superseded AU § 326 for audits of fiscal years beginning on or after December 15, 2010. AU § 326.22, which was effective during the FY 2011 audit of OCZ's financial statements, provides, in relevant part, that "[t]he independent auditor's objective is to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion."

10. Dulek also failed to exercise the requisite due care in auditing OCZ's CBPs because he did not exercise appropriate skepticism or obtain sufficient audit evidence in concluding that CBP credits were properly characterized as marketing expenses. Among other things, due professional care "requires the independent auditor to plan and perform his or her work with due professional care. Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting." AU § 230.02. It also "requires the auditor to exercise *professional skepticism*. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses the knowledge, skill, and ability called for by the profession of public accounting to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence." AU § 230.07. Moreover, PCAOB Standards provide that "[i]n exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." AU § 230.09. And "[t]he independent auditor's objective is to obtain sufficient appropriate evidential matter to provide him or her with a reasonable basis for forming an opinion." AU § 230.11.

Failure to Audit OCZ's Inventory Accounting in Accordance with PCAOB Standards in FY 2011 and 2012

11. In valuing its inventory in FY 2011 and 2012, OCZ included only raw materials in inventory costs—it did not include the labor and overhead costs relating to the manufacture of those goods. This practice was a departure from GAAP, which requires that all direct and indirect acquisition and production expenditures be included in inventory cost. (ASC 330-10-30). OCZ's failure to include labor and overhead in its inventory costs resulted in OCZ's material understatement of costs of goods sold and inventory and overstatement of gross profits in FY 2011 and 2012.

12. The audit work papers indicate that labor and overhead will generally be included in the valuation of inventory. The work papers, however, further state that OCZ did not follow this standard practice and, instead, expensed manufacturing labor and overhead and only included the costs of raw material in the costs recorded in valuing inventory.

13. At the time of the FY 2011 and 2012 audits, Dulek had reviewed evidence that, at a minimum, should have called into question OCZ's failure to include labor and overhead costs in inventory. For example, OCZ's FY 2012 Form 10-K, which Dulek reviewed, stated that OCZ was "a leader in the design, **manufacturing**, and distribution of high performance and reliable Solid-State Drives ("SSDs")" and "OCZ designs and **manufactures** SSDs in a variety of form factors and interfaces." (emphases added). OCZ made similar representations concerning its manufacturing capabilities in its FY 2011 Form 10-K, which Dulek reviewed.

14. PCAOB standards require that audit documentation should "[s]upport the basis for the auditor's conclusions concerning every relevant financial statement assertion" and indicate "the procedures performed, evidence obtained, and conclusions reached" with respect to relevant financial statement assertions. AS Nos. 3.5(b) and 3.6. Dulek failed to ensure that the engagement team adequately documented any information it received or analyzed concerning the magnitude of OCZ's labor and overhead costs, or any procedures the team may have undertaken to obtain and analyze such information, as required by AS Nos. 3.5(b) and 3.6.

15. In addition, by failing to obtain a proper understanding of OCZ's business, as is required by AS No. 12.7, among other auditing standards,⁷ and failing to identify and rectify OCZ's clear GAAP departure, Dulek failed to exercise the requisite due care and skepticism as required by AU § 230.

Failure to Audit Sales Cut-Off in Accordance with PCAOB Standards in FY 2011 and 2012

16. OCZ recognized revenues upon product shipment, even though its shipping terms with most customers provided that OCZ held title to those products until the customer took delivery. OCZ's revenue recognition practice was inconsistent with GAAP, as the company had not earned the revenue until the product was delivered. (*See* ASC 605-10-25-1).

17. As part of its restatement, OCZ concluded that sales of goods that were in transit at the end of its fiscal year had been improperly recorded as revenues in that fiscal year (concluding that the revenues should have been recorded in the subsequent fiscal year).

18. The performance of cut-off testing—a test to determine whether sales recorded near the end of the fiscal year were recorded in the proper period—is a typical audit procedure.

19. In assessing the appropriateness of the timing of revenue recognition, shipping terms are a critical consideration as they determine the point at which title to the product, and thus the risks and rewards of ownership, has legally passed to the buyer.

20. In connection with the FY 2011 audit, the audit work papers, which Dulek signed off on, do not indicate that any shipping terms were reviewed to confirm that the tested sales were recorded in the proper period.

21. In connection with the FY 2012 audit, the audit work papers, which Dulek reviewed, document the shipping terms. However, because the shipping terms with most customers provided that title would pass on product delivery, the engagement team relied on so-called "title transfer letters" as evidence that the shipping terms of the relevant sales had been altered from the terms that otherwise applied to the sales. The letters were conceived by OCZ to purportedly allow it to recognize revenue upon shipment without changing the economic terms of the sales. The only letter included in the audit work papers, which was undated, stated that OCZ would continue to assume "all risks prior to the point that the goods are ready for unloading by the buyer." This indicated that the risk of ownership did not pass to the customer upon shipment and, therefore, revenue recognition would not be appropriate until the product was delivered. Nevertheless, Dulek concluded that the title transfer letters could alter the shipping terms that otherwise applied to the sales to allow revenue recognition upon shipment rather than

⁷ AS No. 12.7 provides, in relevant part, that "[t]he auditor should obtain an understanding of the company and its environment ("understanding of the company") to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement. Obtaining an understanding of the company includes understanding: . . . The nature of the company." AU § 311, which was effective during the FY 2011 audit, similarly provides, among other things, that "[t]he auditor should obtain a knowledge of matters that relate to the nature of the entity's business, its organization, and its operating characteristics." AU § 311.07.

on the date of delivery.

22. In auditing sales cut-off, Dulek failed to properly document the basis for the conclusions that sales were recorded in the proper period in accordance with AS Nos. 3.5(b) and 3.6.

23. Dulek also failed to exercise the requisite due professional care and skepticism, as is required by AU § 230, in failing to obtain the audit evidence to support the conclusions that sales were recorded in the proper period. *See also* AS No. 15 (in connection with the FY 2012 audit) and AU § 326 (in connection with the FY 2011 audit).

Failure to Take Appropriate Steps to Correct OCZ's GAAP Departure with Respect to its Accounting for Sales Returns in FY 2011

24. Under certain circumstances, OCZ permitted customers to return products they purchased. GAAP requires that for sales made with a right of return, revenue reported in the income statement "shall be reduced to reflect estimated returns." (ASC 605-15-45). OCZ improperly recorded only the gross margin on estimated product returns as a reduction in revenues. For example, if OCZ expected \$100 of goods to be returned, and had gross margins of 20%, OCZ recorded only \$20 of sales returns accruals (which reduced net revenues), instead of the full \$100 of goods it expected to be returned.

25. OCZ's practice was documented in the FY 2011 audit work papers, which state: "OCZ reserves the gross margin portion of the sales price (20 percent)."

26. Nevertheless, Dulek failed to note that this was contrary to GAAP and evaluate the effect on OCZ's financial statements, and there is no indication in the audit work papers that the issue was brought to OCZ's attention.

27. Dulek's failure to recognize the GAAP departure in the audit work papers demonstrates a lack of due care as required by AU § 230.

Failure to Adequately Supervise Staff

28. PCAOB standards require auditors to supervise the audit engagement "so that the work is performed as directed and supports the conclusions reached." AS No. 10.2. "[T]he engagement partner is responsible for proper supervision of the work of engagement team members and for compliance with PCAOB standards." AS No. 10.3. The engagement partner should inform staff members of their responsibilities, including, among other things: (1) the objectives of the procedures, (2) the nature, timing, and extent of the procedures to be performed, and (3) any relevant issues that could affect the performance, or evaluation of the results, of the procedures. AS No. 10.5. In determining the extent of supervision, the engagement partner should take into account, among other things, "[t]he risks of material misstatement." AS No. 10.6. Additionally, the engagement partner should review the work of engagement team members "to evaluate whether: (1) [t]he work was performed and documented; (2) [t]he objectives of the procedures were achieved; and (3) [t]he results of the work support the conclusions reached." AS No. 10.5.

29. As described further above, in supervising the FY 2011 and 2012 OCZ audits, Dulek did not ensure that the work of the audit team supported the conclusions reached. Dulek also failed to properly evaluate that the documentation obtained by the audit team supported the conclusions reached by the team. He also failed to properly take account of the risk of material misstatement in determining the extent of his supervision. Accordingly, he violated PCAOB AS No. 10.⁸

FINDINGS

30. Based on the foregoing, the Commission finds that Dulek engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice by engaging in repeated instances of unreasonable conduct indicating a lack of competence to practice before the Commission.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent Dulek is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After three years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
2. an independent accountant. Such an application must satisfy the Commission that:

⁸ AS No. 10 superseded AU § 311 for audits of fiscal years beginning on or after December 15, 2010. AU § 311, which was effective during the FY 2011 audit of OCZ's financial statements, provided, in relevant part, that (a) "Supervision involves directing the efforts of assistants who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished" (AU § 311.11); and (b) "The work performed by each assistant should be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusions to be presented in the auditor's report." (AU § 311.13). Dulek failed to satisfy these standards with respect to the FY 2011 audit.

- (a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board (“Board”) in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;
- (b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent’s or the firm’s quality control system that would indicate that the Respondent will not receive appropriate supervision;
- (c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and
- (d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Brent J. Fields
Secretary