INITIAL DECISION RELEASE NO. 930
ADMINISTRATIVE PROCEEDING
FILE NO. 3-16386

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of TRACI J. ANDERSON, CPA, TIMOTHY W. CARNAHAN, and CYIOS CORPORATION	INITIAL DECISION December 21, 2015

APPEARANCES: Chris Davis and Timothy McCole for the Division of Enforcement, Securities and Exchange Commission

Traci J. Anderson, CPA, *pro se*

Timothy W. Carnahan, *pro se* and for CYIOS Corporation

BEFORE: Cameron Elliot, Administrative Law Judge

SUMMARY

Respondents CYIOS Corporation and Timothy W. Carnahan failed to file required periodic reports and made false statements in Commission filings regarding assessments of CYIOS' internal controls. This Initial Decision: (1) finds that CYIOS violated, and Carnahan caused CYIOS' violations, of Section 13(a) of the Securities Exchange Act of 1934 (Exchange Act) and Rules 13a-1 and 13a-13 thereunder; (2) finds that Carnahan violated Exchange Act Rules 13a-14 and 13a-15(c); (3) finds that CYIOS violated, and Carnahan caused CYIOS' violation of, Section 17(a)(3) of the Securities Act of 1933 (Securities Act), but finds no violation of Section 17(a)(2); (4) orders CYIOS and Carnahan to cease and desist from committing or causing those violations; (5) orders CYIOS to disgorge $37,500 in ill-gotten gains; and (6) orders CYIOS to pay a civil penalty of $375,000 and Carnahan to pay a civil penalty of $75,000.

Respondent Traci J. Anderson acted as an accountant for CYIOS while subject to a direct registered public accounting firm associational bar imposed by the Public Company Accounting Oversight Board (PCAOB) pursuant to Section 105(c)(4) of the Sarbanes-Oxley Act of 2002 and PCAOB Rule 5300(a). Because applying the collateral issuer associational bar of Sarbanes-Oxley Section 105(c)(7)(B) would be impermissibly retroactive, neither Anderson nor CYIOS

violated Section 105(c)(7)(B). I therefore dismiss this proceeding as to Anderson and find no Section 105(c)(7)(B) violations by Carnahan or CYIOS.

I. INTRODUCTION

A. Procedural Background

On February 13, 2015, the Securities and Exchange Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) pursuant to Section 8A of the Securities Act, Sections 4C and 21C of the Exchange Act, and Rule 102(e) of the Commission's Rules of Practice. The OIP alleges that: Anderson and CYIOS violated Sarbanes-Oxley Section 105(c)(7)(B), and Carnahan caused CYIOS' violation; CYIOS violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, and Carnahan caused such violations; and Carnahan violated Rules 13a-14 and 13a-15(c) under the Exchange Act. OIP at 5-6; *see* 15 U.S.C. §§ 7215(c)(7)(B), 77q(a), 78m(a); 17 C.F.R. §§ 240.13a-1, .13a-13, .13a-14, .13a-15(c).

On June 9, 2015, I issued an Order on Motions for Summary Disposition, in which I found, among other things, that: Anderson violated Sarbanes-Oxley Section 105(c)(7)(B) (a finding that, upon reconsideration, this Initial Decision reverses); CYIOS violated, and Carnahan caused CYIOS' violations of, Exchange Act Section 13(a) and Rules 13a-1 and 13a-13; and Carnahan violated Exchange Act Rules 13a-14 and 13a-15. *Traci J. Anderson, CPA*, Admin. Proc. Rulings Release No. 2786, 2015 SEC LEXIS 2280, at *8-17, *22-23 (Jun. 9, 2015). I also found genuine issues of material fact precluded summary disposition on the other alleged violations, as well as on certain issues pertaining to sanctions. *Id*. at *12-13, *19-24. Two of the issues I identified pertaining to sanctions – Anderson's state of mind and whether Carnahan knew or should have known of the PCAOB's Order barring her from being an associated person of a registered public accounting firm – are rendered moot because no violation of Sarbanes-Oxley Section 105(c)(7)(B) occurred. *See id.* at *23.

Anderson, Carnahan, and Charles Lundelius, Jr., who appeared as an expert for the Division, testified during a hearing held in Washington, D.C., on September 2, 2015. The admitted exhibits are listed in the exhibit list accompanying the Record Index issued by the Office of the Secretary on November 9, 2015. The Division and Respondents completed an initial round of post-hearing briefing on October 22, 2015. On October 30, 2015, I issued an Order to Show Cause and Directing Supplemental Briefing on the question of whether – for reasons discussed below – it would be impermissibly retroactive to construe Sarbanes-Oxley Section 105(c)(7)(B) to have prohibited Anderson and CYIOS from their association. *Traci J. Anderson, CPA*, Admin. Proc. Rulings Release No. 3278, 2015 SEC LEXIS 4484. Thereafter, the parties completed briefing on that issue.[1]

[1] Citations to the transcript of the hearing are noted as "Tr. __." Citations to the Division's exhibits are noted as "Div. Ex. __," and citations to Respondents' exhibits are noted as "Resp. Ex. __." The page numbers of certain exhibits are cited to by the last non-zero numerical digits of their Bates numbers. The Division's and Respondents' post-hearing briefs are noted as "Div. Br. __," "Anderson Br. __," and "Carnahan Br. __," respectively. The Division's and

B. Summary of Allegations

The OIP alleges as follows:

Carnahan is the founder and sole officer and director of CYIOS. OIP at 2. Anderson has functioned as the contract CFO of CYIOS since July 2007. *Id.* CYIOS is a defense contractor and had common stock registered under Section 12(g) of the Exchange Act, until it terminated its registration by filing a Form 15-12G on May 30, 2014. *Id.*

On August 12, 2010, the PCAOB issued an order (Order) revoking the registration of Anderson's accounting firm and barring Anderson from being an associated person of a registered public accounting firm. OIP at 3. Anderson thereafter continued to perform accountancy and financial management services for CYIOS. *Id.* Carnahan made the decision to retain Anderson in her role at CYIOS, was notified of the Order, and knew or should have known of the bar on Anderson. *Id.* As a result, Anderson and CYIOS violated Sarbanes-Oxley Section 105(c)(7)(B), and Carnahan caused CYIOS' violation, because that provision "states that it is 'unlawful for any person that is . . . barred from being associated with a registered public accounting firm . . . willfully to become or remain associated with any issuer . . . in an accountancy or financial management capacity . . . without the consent of the [PCAOB] or the Commission.'" *Id*. at 2, 5 (modifications in original).

CYIOS ceased making filings required under Section 13(a) of the Exchange Act after it filed its third quarter 2012 Form 10-Q in November 2012. OIP at 3. Carnahan was responsible for CYIOS not making its required filings. *Id.* at 3-4. Carnahan thereby caused CYIOS to violate Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder. *Id*. at 5-6.

Moreover, CYIOS management – that is, Carnahan – failed to assess internal control over financial reporting (ICFR) and failed to document such assessment. *Id.* at 4-5. CYIOS' Forms 10-K for the 2009, 2010, and 2011 fiscal years, which stated that CYIOS had assessed ICFR, were therefore false. *Id.* In 2010, CYIOS issued common stock in exchange for consulting services and debt conversions. *Id.* at 5. As a result, CYIOS violated Securities Act Sections 17(a)(2) and 17(a)(3), Carnahan caused CYIOS' violations, and Carnahan violated Exchange Act Rules 13a-14 and 13a-15(c). *Id*. at 5-6.

Respondents generally deny the allegations of the OIP. Answer at 7.

II. FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. All documents and exhibits of record have been fully reviewed and carefully considered. I have determined all facts based on the preponderance of the evidence. *See Steadman v. SEC*, 450 U.S. 91, 102 (1981). I

Respondents' reply briefs are noted as "Div. Reply __," "Anderson Reply __," and "Carnahan Reply __," respectively. The Division's and Respondents' briefs on the retroactivity issue are noted as "Div. SOX Br. __," "Anderson SOX Br. __," and "Carnahan SOX Br. __," respectively.

have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision.

A. Anderson's Background

Anderson was born in 1968 and resides in Charlotte, North Carolina, where she works out of her home office. Div. Ex. 1 at 72; Div. Ex. 28 at 1. She received a degree in accounting from the University of South Florida in 1990 or 1991, and did postgraduate coursework in accounting until 1993. Tr. 52; Div. Ex. 28 at 6. She obtained a CPA license in Florida in 1996, and worked in Florida as a CPA from 1996 to 2000. Tr. 53, 130; Div. Ex. 28 at 7, 9. In September 2000, she relocated to North Carolina, where she started her own accounting firm, Traci Jo Anderson, CPA. Tr. 53. She received a CPA license in North Carolina through reciprocity, and maintained that license until 2011. Tr. 56; Div. Ex. 28 at 7. She continues to hold a CPA license in Florida, and she takes eighty hours of continuing professional education courses biannually to maintain her Florida license. Tr. 55-56, 124.

In 2003, she registered her firm with the PCAOB. Tr. 57. On August 12, 2010, the PCAOB issued the Order, which revoked the registration of Anderson's accounting firm and barred Anderson from being an associated person of a registered public accounting firm, pursuant to Sarbanes-Oxley Section 105(c)(4) and PCAOB Rule 5300(a). Div. Ex. 5 at 18. Although Anderson consented to the Order without admitting its findings, the basis of the Order was Anderson's "numerous and repeated violations of PCAOB rules and auditing standards" in auditing the financial statements of three different issuers from 2007 to 2009. *Id.* at 1, 2-4. Anderson concedes that the Order was issued because of "deficiencies in [her] audits." Tr. 131.

Within approximately one month thereafter, Anderson advised all her audit clients that she had to withdraw from her engagements. Tr. 89; Div. Ex. 1 at 90. There are five letters in the record from Anderson to clients that inform the clients of the PCAOB's bar. Div. Ex. 9. All five letters state that she "do[es] not agree with the PCAOB's finding," but that she "had no choice but to come to a settlement agreement with the PCAOB." *Id.*

Anderson was familiar with Sarbanes-Oxley Section 105(c), especially prior to July 2010. Tr. 97-98. She does not recall whether she read the version of Sarbanes-Oxley Section 105(c) that became effective in July 2010, after the Order issued on August 12. Tr. 99-102. She knew what the Order was going to say "probably about a month" ahead of the Order issuing. Tr. 99. Her understanding, based in part on the advice of her attorney, was that she could still do accounting and tax work while subject to the PCAOB's bar. Tr. 98, 114-15. Her intended "career path" after the Order was to perform accounting and tax work or work as an "outside CFO for companies," instead of auditing. Tr. 98, 131; Div. Ex. 1 at 97. Anderson stated that "I never at any time felt that doing accounting work [for an issuer after the Order issued] was something illegal or against rules that I couldn't do." Tr. 131.

As a result of the PCAOB's bar, the American Institute of Certified Public Accountants terminated Anderson's membership in September 2010. Div. Ex. 1 at 104-05; Div. Ex. 23 at 1. Also based on the PCAOB's bar, in January 2012 the North Carolina State Board of Certified Public Accountant Examiners (NC Board) barred Anderson and her firm from engaging in any

"attest of assurance services," with certain exceptions inapplicable here, and imposed a $1,000 civil monetary penalty. Div. Ex. 23 at 2. In April 2014, the NC Board ordered Anderson to cease and desist from holding herself out as a CPA in North Carolina. Div. Ex. 25. The cease-and-desist order was based on Anderson's failure to renew her license for the 2011-12 renewal period, which resulted in license forfeiture effective September 2011, and Anderson's subsequent characterization of herself as a CPA when she sought a tax identification number from the IRS for use in providing tax services to clients while having a principal place of business in North Carolina. *Id.* She testified that her self-characterization was inadvertent and a "computer glitch." Tr. 124, 134-35.

In June 2014, during the investigation, Anderson completed a background questionnaire that omitted any mention of the disciplinary proceedings by the NC Board that had concluded just two months before. Tr. 106-07; Div. Ex. 28 at 7. Although she characterized this as an "oversight," and testified that her responses to the questionnaire contained "just what I recalled at the point in time I put [them] down," she testified during the investigation that her responses were complete and accurate at the time. Tr. 107-09; Div. Ex. 1 at 9-10. As of August 12, 2014, she routinely used an email address that included the expression "tracijcpa." Tr. 104-05; Div. Ex. 9 at 158. She did not consider her email address to constitute "holding out services in North Carolina." Tr. 105.

B. Background of Carnahan and CYIOS

Carnahan is approximately forty-eight years old and earned a bachelor's degree in computer science from Old Dominion University in 1989. Div. Ex. 2 at 15-16, 17-19; Div. Ex. 4; Div. Ex. 12 at 281. He lives in Washington, D.C., and Pompano Beach, Florida. Div. Ex. 2 at 17; Div. Ex. 29 at 7. Although he has no formal education in accounting, he considers himself "well versed with accounting." Div. Ex. 2 at 16-18. After college graduation, he worked for the U.S. Senate Sergeant at Arms, "[running] all the computer systems for every Senator." *Id*. at 18. He then started CYIOS in 1994 and another company, CKO, Inc., in 2004. *Id*. at 20; Tr. 153. CYIOS became a public company by reverse merger in September 2005, and since 2005 Carnahan has been CYIOS' CEO, treasurer, and chairman of the board. Tr. 154; Div. Ex. 2 at 20-21. Since July 2007, he has been CYIOS' sole officer and director, and he makes all important decisions for the company. Tr. 154; Div. Ex. 2 at 21.

CYIOS is a Nevada corporation headquartered in Washington, D.C., that serves as a holding company for two operating subsidiaries. Div. Ex. 21 at 490. One of those subsidiaries, also called CYIOS Corporation, is a District of Columbia corporation that "builds knowledge management solutions [and] supports organizations with business continuity and IT services for the Department of Defense." Tr. 154; Div. Ex. 3 at 100. CKO is the second of CYIOS' operating subsidiaries and its "product arm." Div. Ex. 3 at 100. CKO offers CYIPRO, a "business transformation tool" that "provides a virtual work space for collaboration, project management, and document management to help manage people, processes and information." *Id.* CYIPRO is a "secure, web-based virtual office that uses an array of tools to give any organization the ability to manage and retain knowledge, collaborate data and ideas, and securely store and share information." *Id.* at 101.

CYIPRO also "provides key solutions for compliance with [Commission] Sarbanes-Oxley regulations and compliance with Defense Contract Audit Agency ('DCAA') and performance based contracting for government contractors." *Id.* at 100. How CYIPRO accomplishes this is not clear. The most detailed description of CYIPRO in the record concerns its functionality as a personnel timekeeping system. *See* Resp. Ex. 3 at 1-2 (of 3 pdf pages). The description also claims that CYIPRO allows "accurate quantification of the costs on each project and process," and provides for "continuous improvement and planning." *Id.* at 2 (of 3 pdf pages). The description does not cite Sarbanes-Oxley, Commission regulations, or ICFR. *See generally id.*

In 2011, CYIOS had fifteen full-time employees, sales of approximately $1.9 million, and net income of approximately $119,000. Div. Ex. 3 at 102, 111. As of the third quarter of 2012, CYIOS had year-to-date sales of approximately $1 million and year-to-date net losses of approximately $76,000. Div. Ex. 21 at 492. CYIOS is traded, generally thinly, as a penny stock on the OTC Bulletin Board. Div. Ex. 21 at 510; Div. Ex. 26. I take official notice under 17 C.F.R. § 201.323 that CYIOS' most recent periodic filing was a Form 10-Q/A for the third quarter of 2012, filed in November 2012. Div. Ex. 21. I also take official notice that CYIOS had common stock registered under Section 12(g) of the Exchange Act, and that on May 30, 2014, CYIOS filed a Form 15-12G to terminate that registration. Tr. 190-92; Div. Ex. 2 at 120; CYIOS Form 15-12G filed May 30, 2014. The termination of registration took effect ninety days later, on August 28, 2014. *See* 17 C.F.R. § 240.12g-4(a).

C. Carnahan Engaged Anderson as an Accountant for CYIOS

Anderson performed CYIOS' 2005 and 2006 audits, and resigned as its auditor in 2007 so that she could perform CYIOS' accounting work. Div. Ex. 1 at 10-11, 13-14; Div. Ex. 6. Between 2007 and 2015 she performed "CFO services" for CYIOS as a consultant and independent contractor. Tr. 59-60; Div. Ex. 1 at 14. Anderson performed work for CYIOS for approximately nine years, and although most of her work involved accounting and bookkeeping, she also handled duties related to payroll, finance, human resources, contracting, and "chasing invoices." Tr. 128; Div. Ex. 1 at 24; Div. Ex. 11 at 254. She stopped performing work for CYIOS sometime after July 25, 2014, when she gave her investigative testimony. Tr. 182; Div. Ex. 1 at 14-15.

Between August 2010 and July 2014, while subject to the Order, Anderson was responsible for CYIOS' day-to-day financial operations and performed its accounting work, although others also did some of its accounting work at various times. Tr. 70, 122; Div. Ex. 1 at 11, 14-15, 76-77. She was responsible for preparation of financial statements for Commission filings and maintained (but did not select or determine) CYIOS' accounting principles, practices, procedures, and initiatives. Div. Ex. 1 at 28, 77-78; Div. Ex. 2 at 42; Div. Ex. 6. The engagement letter between CYIOS and Anderson, signed by Anderson and dated July 25, 2007, lists six services Anderson was to perform: (1) general accounting, advising, and consulting services; (2) monthly reconciliation of general accounts to the sub ledger accounts; (3) preparation of monthly financial statements; (4) preparation of quarterly financials for the Form 10-QSB; (5) preparation of annual financials for the Form 10-KSB; and (6) special

accounting projects as requested. Div. Ex. 6. Almost every entry in her invoices and CYIOS' records describes her work as "accounting" or the like. Div. Exs. 8, 10.

As of July 25, 2014, when she gave her investigative testimony, CYIOS' website identified her as "Traci Anderson, CFO," although CYIOS' management team was described differently in CYIOS' Commission filings. Div. Ex. 1 at 74, 80; Div. Ex. 4; *e.g.*, Div. Ex. 12 at 26 (identifying Carnahan as the only officer of CYIOS). Anderson also identified herself on her LinkedIn page as "CFO at CYIOS Corporation." Div. Ex. 1 at 83; Div. Ex. 7. Her LinkedIn page stated that she had been CYIOS' CFO since January 2006, and although she agreed that was incorrect, she testified she did not know why her LinkedIn page indicated that. Div. Ex. 1 at 83-84; Div. Ex. 7. Her LinkedIn page also stated that CYIOS was privately held – a fact she agreed was erroneous and that she testified she did not put on her LinkedIn page. Div. Ex. 1 at 83-87; Div. Ex. 7.

Anderson also performed tax services for CYIOS and other clients. Div. Ex. 1 at 15, 90. Between August 2010 and July 2014, CYIOS provided the majority of her compensation. Div. Ex. 1 at 98. Between August 12, 2010, and June 20, 2014 (the last entry in CYIOS' books showing payment to Anderson prior to CYIOS' termination of registration of its stock), CYIOS paid her $244,835.48. Div. Exs. 8, 10; Div. Motion for Summary Disposition at 6-7.

Anderson was aware at the time the Order issued that CYIOS was a public company, and was aware that it remained a public company until 2014. Tr. 87, 89-90. She never asked the PCAOB or the Commission for permission to continue her work at CYIOS, and she did not think she had to because she was no longer associated with a registered public accounting firm. Tr. 101; Div. Ex. 1 at 96-97.

Anderson reported to Carnahan, who had the final say on, and signed, CYIOS' financial statements. Tr. 64. Within a month or so after the Order issued, Anderson told Carnahan about it, explained to him how to access it on the PCAOB website, and asked him to let her know if he had any questions about it. Tr. 88-89. She also told Carnahan that she could not do any more audit work and that she would have no more audit clients. Tr. 199-200. The scope of her services to CYIOS did not change as a result of the Order. Div. Ex. 1 at 94. Carnahan stated at the hearing that he knew of the Order at the time, but that "[i]t just didn't apply" to him and that he "would never fire [Anderson] because of that order." Tr. 45, 48, 178.

D. CYIOS' Periodic Filings and Securities Offerings

Carnahan was responsible for CYIOS' periodic filings, personally "EDGARized" them and transmitted them electronically, and knew that CYIOS failed to file them between November 2012 and May 2014. Tr. 64, 155-57; Div. Ex. 2 at 40-41, 58, 60, 77. Carnahan purposefully decided to stop making CYIOS' periodic filings because the company could not afford to do so. Tr. 191; *see* Answer at 4 ("CYIOS was having financial hardship and was not able to continue paying for auditors and lawyers for the filings").

CYIOS' Forms 10-K for fiscal years 2009, 2010, and 2011, and its Forms 10-Q filed between first quarter 2010 and third quarter 2012, all stated that CYIOS management had

assessed the effectiveness of its ICFR for the relevant reporting period using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control-Integrated Framework (COSO framework), and concluded that CYIOS' ICFR was effective. *E.g.*, Div. Ex. 3 at 118; Div. Ex. 13 at 310; Div. Ex. 21 at 505. But Carnahan could not explain how management – that is, Carnahan – so "assessed the effectiveness of [CYIOS' ICFR]" after 2007, under COSO or any other framework. *See* Div. Ex. 21 at 505; *see also* Div. Ex. 2 at 63-65, 72-75. Carnahan testified at the hearing that he "wrote the code that processes all money in the company conclusively," and that he has "total accountability, internal controls, written down in code for all the money in, all the money out." Tr. 187, 189; *see* Div. Ex. 2 at 65. But he testified during the investigation that: (1) CYIOS had no documentation of ICFR except each periodic filing itself; (2) he is his own "quality assurance"; (3) he serves simultaneously as CYIOS' president, CEO, principal financial officer, principal accounting officer, and sole director; and (4) he was not sure whether CYIOS ever assessed its internal controls after 2007. Div. Ex. 2 at 63, 66-67, 72-73, 75. As Carnahan succinctly put it, "I am the internal control." *Id.* at 72.

CYIOS issued stock from time to time, sometimes as payment for services. *See* Div. Ex. 11 at 242; Div. Ex. 12 at 277. On three occasions in 2010, CYIOS issued stock as compensation to marketing consultants: 100,000 shares on March 24 valued at $6,000, 450,000 shares on March 31 valued at $18,000, and 450,000 shares on October 27 valued at $13,500. Tr. 68-70, 192-93; Div. Ex. 12 at 277. CYIOS booked the compensation as a "Prepaid and Other Current" asset. *See* Tr. 74-78, 159; Div. Ex. 13 at 292, 303. CYIOS' paid-in capital and cash flow increased as a result of the arrangement, although in a "noncash" way. Tr. 75-77; Div. Ex. 12 at 273-74.

E. Expert Evidence

Charles R. Lundelius, Jr., CPA, testified as the Division's expert. Tr. 206. He graduated from the University of Virginia in 1978 with a bachelor of science in commerce with a major in accounting, and graduated from Tulane University in 1980 with a master's in business administration and a concentration in finance. Div. Ex. 24, Appendix A at 22. Between 1989 and 1992 he was the CFO of the Markman Company, including its affiliate, Unimark Life Insurance Company. Div. Ex. 24 at 3. Between 1992 and 2012 he worked as a forensic accountant at Deloitte, Coopers & Lybrand, and FTI Consulting, Inc., and since 2012 he has been managing director of the capital markets group at Berkeley Research Group, LLC. *Id.* He is the author of *Financial Reporting Fraud: A Practical Guide to Detection and Internal Control*, published by the American Institute of Certified Public Accountants. *Id.* at 4. He has testified as an expert in over fifty different cases in the past twenty years. *Id.*, Appendix A at 1.

Insofar as Lundelius expressed opinions on ultimate issues, I accord those opinions no weight; for example, I place no weight on his opinion that Anderson and Carnahan failed to comply with Sarbanes-Oxley Section 105(c)(7)(B). *See id.* at 27-29. However, Lundelius also opined in his expert report on four broad questions that are not ultimate issues. *See generally* Div. Ex. 24. First, he opined that disclosures regarding whether or not an issuer has implemented effective internal controls are material. *Id.* at 6-11. Second, he opined that disclosures regarding whether or not an issuer has implemented a suitable and recognized control

framework are material. *Id.* at 11. Third, he opined that Anderson's duties at CYIOS appear to have overlapped with those of a corporate controller, and that under COSO, Carnahan should have considered the impact of the PCAOB's investigation of Anderson on CYIOS' internal controls. *Id.* at 16-17, 21-24, 27; *see also* Tr. 221. Fourth, he opined that under COSO, Anderson and Carnahan were "obligated to make reasonable efforts to understand and comply with the terms of the [Order]," and that both Anderson and Carnahan failed to abide by COSO because Carnahan continued to engage Anderson as an accountant after the Order issued. Div. Ex. 24 at 27-29.

Lundelius opined at the hearing on several other issues, including that: (1) under COSO, if CYIOS' software failed to detect the Order automatically, then a manual process for detecting it (such as checking the PCAOB's website) would have been required; (2) compliance with COSO standards cannot be achieved merely by compliance with ISO standards; and (3) CYIOS lacked human resources internal controls. *See* Tr. 213-15. Two other opinions warrant attention. First, Lundelius opined that Carnahan's role as both CEO and CFO created a "significant" ICFR risk because CYIOS lacked segregation of duties. Tr. 207-08; *see* Tr. 217-20. Lundelius noted that the degree of segregation of duties depends on the complexity of the organization, but that even a very small company can segregate duties by retaining individuals to perform a few functions. Tr. 219-20. Second, Lundelius opined that Carnahan possessed a "very serious" lack of understanding of Sarbanes-Oxley Section 105(c)(7). Tr. 221. Lundelius spent seven years as a member of the NASDAQ listing qualifications panel, and testified that had he heard Carnahan's testimony while a member of that panel, he would have "called the general counsel at NASDAQ and asked that [NASDAQ] immediately place a halt on trading in CYIOS." Tr. 222.

III. DISCUSSION

A. Neither Anderson nor CYIOS Violated Sarbanes-Oxley Section 105(c)(7) Because Its Application Here Would Be Impermissibly Retroactive

Sarbanes-Oxley Section 105(c)(4)(A) and (B) authorize the PCAOB to revoke the registration of a registered public accounting firm and to bar an individual from being an associated person of a registered public accounting firm. 15 U.S.C. § 7215(c)(4)(A), (B). Pursuant to those provisions, the Order revoked the registration of Anderson's accounting firm and barred Anderson from being an associated person of a registered public accounting firm. Div. Ex. 5 at 18. The PCAOB imposed those sanctions for "numerous and repeated violations of PCAOB rules and auditing standards" that Anderson committed from 2007 to 2009 in connection with auditing the financial statements of three different issuers (auditing misconduct). *Id.* at 1, 2-5, 11, 15 .

Sarbanes-Oxley Section 105(c)(7) sets out the collateral legal consequences of a PCAOB bar or suspension. Specifically, during the 2007 to 2009 period of Anderson's auditing misconduct, Sections 105(c)(7)(A) and (B) said the following:

> (7) Effect of suspension
>
> (A) Association with a public accounting firm

> It shall be unlawful for any person that is suspended or barred from being associated with ***a registered public accounting firm*** under this subsection willfully to become or remain associated with any ***registered public accounting firm***, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.
>
> (B) Association with an issuer
>
> It shall be unlawful for any person that is suspended or barred from being associated with ***an issuer*** under this subsection willfully to become or remain associated with ***any issuer*** in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

15 U.S.C.A. § 7215(c)(7)(A), (B) (West 2009) (emphasis added).

Effective July 22, 2010 – after Anderson's auditing misconduct but before the Order issued on August 12 – the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Sarbanes-Oxley Section 105(c)(7) in the following manner (insertions bolded, deletions struck through):

> (7) Effect of suspension
>
> (A) Association with a public accounting firm
>
> It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.
>
> (B) Association with an issuer**, broker, or dealer**
>
> It shall be unlawful for any person that is suspended or barred from being associated with ~~an issuer under this subsection~~ **a registered public accounting firm under this subsection** willfully to become or remain associated with ~~any issuer~~ **any issuer, broker, or dealer** in an accountancy or a financial management capacity, and for ~~any issuer~~ **any issuer, broker, or dealer** that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

See Dodd-Frank, Pub. L. No. 111-203, §§ 4, 982(f), 124 Stat. 1376, 1390, 1929-30 (2010); *compare id. with* Sarbanes-Oxley, Pub. L. No. 107-204, § 105(c)(7), 116 Stat. 745, 763-64 (2002) *and, e.g.*, 15 U.S.C.A. § 7215(c)(7) (West 2009); *see also* Div. SOX Br. at 1, n.1.

Before the July 2010 amendment and throughout the 2007 to 2009 period of Anderson's auditing misconduct, the plain text of Section 105(c)(7)(B) made it unlawful for a person to associate with an issuer (like CYIOS) in an accountancy or financial management capacity only

if that person had been "suspended or barred from being associated with *an issuer* under this subsection." 15 U.S.C.A. § 7215(c)(7)(B) (West 2009) (emphasis added). Yet the Order did not bar Anderson from associating with an issuer; it barred her from associating with "a registered public accounting firm." Div. Ex. 5 at 18. It was only after Anderson's auditing misconduct, and less than a month before the Order issued in August 2010, that the text of Section 105(c)(7)(B) was amended to make associating with an issuer in an accountancy or financial management capacity unlawful by virtue of being barred from associating with a registered public accounting firm, as Anderson was.

I initially ruled on summary disposition that the post-Dodd-Frank version of the statute applies, and that Anderson and CYIOS were therefore prohibited from their association. *Traci J. Anderson, CPA*, Admin. Proc. Rulings Release No. 2786, 2015 SEC LEXIS 2280, at *8-17, *22-23 (Jun. 9, 2015). Thereafter, the U.S. Court of Appeals for the District of Columbia Circuit held that a separate provision of Dodd-Frank could not be applied retroactively. *See Koch v. SEC*, 793 F.3d 147, 157-58 (D.C. Cir. 2015). On reconsideration, and in view of *Koch*, I conclude that applying the post-Dodd-Frank version of Section 105(c)(7)(B) here would be impermissibly retroactive. Throughout the period of Anderson's auditing misconduct – that is, before the Dodd-Frank amendment – the provision's text did not provide that an individual barred from associating with a registered public accounting firm was also collaterally barred from associating with an issuer.

"[C]ourts do not enforce a statute retroactively unless the 'Congress first make[s] its intention clear.'" *Koch*, 793 F.3d at 157 (quoting *Landgraf v. USI Film Prods.*, 511 U.S. 244, 268 (1994)) (second alteration in original). "[The] first task, then, is to determine 'whether Congress has expressly prescribed the statute's proper [temporal] reach.'" *Id.* (quoting *Landgraf*, 511 U.S. at 280) (second alteration in original).

The Division concedes that "Congress did not expressly authorize retroactive application [of Section 105(c)(7)(B)]." Div. SOX Br. at 7 n.5. The amended provision does not mention retroactive application. 15 U.S.C.A. § 7215(c)(7)(B); Pub. L. No. 111-203, § 982(f), 124 Stat. 1376, 1929-30 (2010). "The closest the Act comes is its generic statement that '[e]xcept as otherwise specifically provided in this Act,' the Act's provisions 'shall take effect 1 day after the date of enactment,'" that is, July 22, 2010. *Koch*, 793 F.3d at 157 (quoting Dodd-Frank). "[T]his language says nothing about retroactivity," as "'[a] statement that a statute will become effective on a certain date does not even arguably suggest that it has any application to conduct that occurred at an earlier date.'" *Id.* at 158 (quoting *Landgraf*). The legislative history of Dodd-Frank's amendment also is devoid of any suggestion of retroactive application. *E.g.*, H.R. Conf. Rep. No. 111-517, at 564, 2010 U.S.C.C.A.N 722 (2010) (merely reflecting textual amendments).

Because retroactive application is not authorized expressly, the next step is to determine whether the amended provision's application here would have a genuine retroactive effect and therefore be impermissible. *Landgraf*, 511 U.S. at 277, 280. That is, "whether it would impair rights a party possessed when [she] acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *Id.* at 280; *see Koch*, 793 F.3d at 158. Or, put "slightly different[ly]," whether retroactive application "attaches new legal

consequences to events completed before its enactment." *Koch*, 793 F.3d at 158 (quoting *Landgraf* and holding as impermissibly retroactive the Commission barring an individual from areas of securities industry for conduct predating Dodd-Frank's authorization of those bars).

Like in *Koch*, here the Division seeks to attach new legal consequences authorized by Dodd-Frank to conduct pre-dating the law's enactment. Before Section 105(c)(7)(B)'s amendment and during Anderson's auditing misconduct, it was not unlawful for a person to associate with an issuer in an accountancy or financial management capacity by virtue of being barred from associating with a registered public accounting firm. Rather, it was only unlawful to do so if that person had been barred from associating with an issuer, which Anderson had not been. *See supra*. The Dodd-Frank amendment thus expanded the scope of the registered public accounting firm associational bar to include a prohibition on association with an issuer. Its application to Anderson would, therefore, unquestionably attach "new legal consequences" to her auditing misconduct – which was "over and done" before Dodd-Frank amended the statute. *Koch*, 793 F.3d at 158 (internal quotation marks and citations omitted); *see also Marrie v. SEC*, 374 F.3d 1196, 1198, 1208 (D.C. Cir. 2004) (holding that Commission rule amendment clarifying mental state necessary for sanction was impermissibly retroactive when applied to respondents for conduct pre-dating amendment).

The Division's arguments to the contrary are unpersuasive. First, the Division argues the amendment was "merely clarifying" a "drafting error," and that "[i]t is clear from the text of the original SOX provision . . . that Congress *always* intended for a PCAOB [registered public accounting firm] associational bar to also prohibit association with issuers." Div. SOX Br. at 2-3. I agree with Anderson that the Division's assertions about Congress' intent are speculative. *See* Anderson SOX Br. at 1. The Division cites no supporting evidence other than the original text and the fact of the amendment. *See* Div. SOX Br. at 5 n. 3 (conceding "Congress was silent" on whether the amendment was clarifying).

If anything, the scant legislative history on the original provision undercuts the Division's argument. *See* S. Rep. No. 107-205 at 11, 48-49, 2002 WL 1443523 (2002) ("Potential sanctions include revocation or suspension . . . of the ability of particular individuals to . . . become associated with any other registered accounting firm (effectively barring the subject of the sanction from participating in audits of public companies)."). Had Congress in 2002 intended the issuer prohibition to result from a registered public accounting firm associational bar, one might expect Congress to have mentioned it when discussing what the bar "effectively" accomplished with respect to restricting activities performed for "public companies," i.e., issuers. *See id.* Likewise, one would have expected the PCAOB's rules, adopted nearly two years after the enactment of Sarbanes-Oxley, to have referenced the issuer prohibition in the rule governing "Effect of Sanctions . . . on Persons." *See* PCAOB Rule 5301(a), PCAOB Release No. 2003-015, http://pcaobus.org/Rules/Rulemaking/Docket%20005/Release2003-015.pdf, *effective pursuant to* Exchange Act Release No. 34-49704, 2004 WL 1439833 (May 14, 2004). However, the only "effect" referenced is that corresponding to Sarbanes-Oxley Section 105(c)(7)(A), making it unlawful to associate with *a registered public accounting firm* if one is barred from doing so. *Id.*

But regardless of congressional intent, the Dodd-Frank amendment cannot be cast as "mere clarification," rather than a change affecting substantive rights. The amendment replaced the term "issuer" with the term "registered public accounting firm," which are both unambiguously defined in Sarbanes-Oxley to mean different things, and whose meanings "shall apply" unless "otherwise specifically provided." 15 U.S.C. § 7201(7), (12). Thus, the original provision was unambiguous and not susceptible to being made "'even more unmistakably clear.'" Div. SOX Br. at 4 (quoting *United States v. Montgomery Cty.*, 761 F.2d 998, 1003 (4th Cir. 1985)). As "the plain language . . . [was] not ambiguous," I am "bound by what Congress has written." *Mart v. Gozdecki, Del Giudice, Americus & Farkas LLP*, 910 F. Supp. 2d 1085, 1095 (N.D. Ill. 2012) (holding retroactive application impermissible where Dodd-Frank amendment to Sarbanes-Oxley provision "alter[ed] rather than clarifie[d]" it); *see Liquilux Gas Corp. v. Martin Gas Sales*, 979 F.2d 887, 890 (1st Cir. 1992) (posing inquiry as "whether new legislative action is alteration, or merely clarification").

At best, the amendment altered or corrected – rather than "clarified" or "restated" – the statute. The cases cited by the Division demonstrate that in such circumstances, retroactive application is impermissible. *See, e.g.*, *Montgomery Cty.*, 761 F.2d at 1003 ("It is true, of course, that a statute which has all along unambiguously proclaimed WHITE cannot retrospectively be made to assert BLACK just because the legislature, at the later date, says so."). Even accepting the notion that the amendment clarified an ambiguity, where a rule "was unclear at the time of the sanctioned conduct" and "had not [been] clarified" until later, Anderson "could not be held to have known of the change at the time of [her]" auditing misconduct that formed the basis of the Order. *Marrie*, 374 F.3d at 1198, 1208. Therefore, "application of the amended Rule . . . to conduct [predating the amendment would be] impermissibly retroactive," even if the amendment "rectified [a] lack of clarity," because doing so would "impose[] new legal consequences" on Anderson, who "did not have fair notice" of what "[she] could be sanctioned for." *Id.* at 1207-09.

Second, the Division argues that under *Koch*, the Dodd-Frank amendment at issue was "merely procedural" because "the only ambiguity was whether the issuer associational bar was automatic or required the PCAOB to specifically bar the person from 'associating with an issuer.'" Div. SOX Br. at 6. But *Koch* deemed part of a separate Dodd-Frank statutory amendment "procedural" only because it related to the *Division's* conduct – specifically, its pursuit of multiple industry bars in one proceeding rather than having to initiate follow-on proceedings for each. *See* 793 F.3d at 157 n.3 (citing *Landgraf*, 511 U.S. at 275). The amendment here did not alter rules of secondary conduct governing, for example, the type or number of proceedings by which sanctions are sought. Rather, the amendment changed the substantive effect of a particular sanction – the registered public accounting firm associational bar under Section 105(c)(4)(B) – to make it more severe by adding a collateral prohibition on associating with issuers. It therefore attached "new legal consequences" to primary conduct by "including [an] *additional* association[al bar]" as a collateral consequence. *Koch*, 793 F.3d at 158.

The Division also argues that the statute's reference to an issuer bar demonstrates that "the issuer . . . bar has been available since SOX was passed in 2002." Div. SOX Br. at 2, 6-7. But a direct issuer bar has never been one of the enumerated sanctions available to the PCAOB.

See 15 U.S.C.A. § 7215(c)(4) (listing sanctions the PCAOB may impose). The original statute stated that the PCAOB may "impose such disciplinary or remedial sanctions as it determines appropriate . . . including . . . any other appropriate sanction provided for in the rules of the Board," but the PCAOB rules have never expressly provided for an issuer bar as an independent sanction, either directly or indirectly. 15 U.S.C.A. § 7215(c)(4)(G) (2009); *see* PCAOB Rule 5300, http://pcaobus.org/Rules/PCAOBRules/Documents/All.pdf (May 19, 2014); PCAOB Release No. 2003-015, http://pcaobus.org/Rules/Rulemaking/Docket%20005/Release2003-015.pdf (Sept. 29, 2003). In any event, even assuming that the PCAOB could have imposed a direct issuer bar prior to Dodd-Frank, a collateral issuer bar was not authorized at the time of Anderson's auditing misconduct.

Finally, the Division asserts that "there is no retroactivity issue because it is the PCAOB Order itself – not Anderson's underlying misconduct – that triggered the issuer associational bar (i.e., the relevant conduct is Anderson's consent to the Order and its subsequent execution by the PCAOB)." Div. SOX Br. at 6 n.4. Because the Dodd-Frank amendment took effect a few weeks before the Order issued, the argument goes, "Anderson was on notice before agreeing to the PCAOB Order that the issuer associational bar would be an automatic consequence of that agreement." *Id.*

Admittedly, had Anderson explicitly agreed to an issuer bar in settling her PCAOB proceeding, she would have had no cause to complain about retroactivity. But the record indicates that Anderson's consent was obtained before the July 22, 2010, effective date of Dodd-Frank.[2] That is, Anderson neither explicitly nor implicitly consented to an issuer bar because she was not actually on notice at the time that it would be a collateral consequence of her settlement with the PCAOB. Anderson testified to that effect. *See* Tr. 131-32; Anderson Br. at 1 ("it's unfair to hold me to an additional legal restriction of which I was not given notice"). Although Anderson's testimony was sometimes non-responsive and hostile, and she may have later learned that an issuer bar was a collateral consequence of the Order, her demeanor when testifying on this point was straightforward and believable.

Her testimony was also plausible. It is not intuitive that an issuer associational bar would necessarily flow automatically from a registered public accounting firm associational bar. Accounting work in the general case is different from auditing work, and potentially much wider in scope. *See* Div. Ex. 24 at 16-17 (describing duties of corporate controller). It seems much more reasonable that lack of fitness for accountancy or financial management would disqualify an accountant from auditing, rather than that lack of fitness for auditing would disqualify an accountant from, say, "[m]anag[ing] the budgeting process" or "[p]rocess[ing] payroll." *See id.* Holding a CPA license may be an indispensable credential for an auditor, but it is not required for employment as even a high-level accountant for an issuer. *E.g., SEC v. Todd*, 642 F.3d 1207,

[2] *See* Tr. 98 ("I had read [Section 105(c)] more before it had changed in July . . . when . . . we were going back and forth with the settlement"); Tr. 99 ("it was probably about a month before . . . the final order came out, that I knew what the order was going to say. And of course at that time, yes, I read [Section 105(c)] and I read it [earlier] when we were going through settlement").

1212-13 (9th Cir. 2011) (company's controller was a CPA, but its CFO was not). I also note that recent PCAOB settlement orders barring individuals from associating with registered public accounting firms consistently state that "[a]s a consequence of the bar, the provisions of Section 105(c)(7)(B) of [Sarbanes-Oxley] will apply," and such orders quote the language of Section 105(c)(7)(B), whereas the Order included no such language. *Traci J. Anderson, CPA*, 2015 SEC LEXIS 4484 (citing as example *David A. Aronson, CPA*, PCAOB Release No. 105-2015-034, at 10 n.25 (Oct. 2, 2015), http://pcaobus.org/Enforcement/Decisions/Documents/David_A_Aronson.pdf).

In the absence of any consent to an issuer bar, it is Anderson's auditing misconduct, rather than her settlement, that is the "relevant conduct" in determining Section 105(c)(7)(B)'s proper temporal reach. *See* Div. SOX Br. at 6 n.4. Retroactivity concerns arise when new legislation purports to regulate a party's underlying primary conduct – for example, when a statute increases liability for past conduct – as opposed to secondary conduct of litigation. *See, e.g.*, *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 951 (1997) (retroactivity concerns not implicated when a statute "can fairly be said merely to regulate the secondary conduct of litigation and not the underlying primary conduct of the parties"); *Landgraf*, 511 U.S. at 275 ("Because rules of procedure regulate secondary rather than primary conduct, the fact that a new procedural rule was instituted after the conduct giving rise to the suit does not make application of the rule at trial retroactive."), 280 (where Congress has not "expressly prescribed the statute's proper reach," "the court must determine whether the new statute would have retroactive effect, *i.e.*, whether it would impair rights a party possessed when [she] acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed"). For retroactivity purposes, the relevant conduct here is the sanctioned conduct. *See Marrie*, 374 F.3d at 1198-99, 1209 (holding that a Commission rule amendment would be impermissibly retroactive if applied to the "sanctioned conduct" – alleged misconduct in auditing – that occurred before the amendment). The Order only sanctions Anderson's auditing misconduct, which was committed at a time when an issuer bar was not an explicit direct or collateral sanction. Div. Ex. 5 at 1 ("the Board is imposing these sanctions on the basis of its findings concerning Respondents' violations of PCAOB rules and auditing standards in auditing the financial statements of three issuer clients from 2007 to 2009"); *cf. United States v. Ward*, 770 F.3d 1090, 1092-94 (4th Cir. 2014) (holding that "[t]he fact that [defendant] was not sentenced for his crimes until after the statute was amended is immaterial because the relevant conduct . . . is the initial offense," where sentencing provision was amended three months before guilty plea but three months after initial criminal conduct (internal quotation marks and citation omitted)).

In short, to the extent the Order purports to impose a collateral issuer bar, it is *ultra vires*. Therefore, application of the post-Dodd-Frank version of Sarbanes-Oxley Section 105(c)(7) to both Anderson and CYIOS is impermissibly retroactive, neither Anderson nor CYIOS violated Section 105(c)(7), and Carnahan caused no such violation.

B. CYIOS Violated, and Carnahan Caused CYIOS to Violate, Exchange Act Section 13(a) and Rules 13a-1 and 13a-13

Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Exchange Act Section 12 to file annual and quarterly reports with the Commission. 15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.13a-1, .13a-13. Scienter is not required to establish violations of Exchange Act Section 13(a) and Rules 13a-1 and 13a-13. *See SEC v. McNulty*, 137 F.3d 732, 740-41 (2d Cir. 1998); *SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978). The record, including facts officially noticed, demonstrates that: (1) CYIOS had a class of securities registered under Exchange Act Section 12 as of November 21, 2012; (2) CYIOS filed a Form 15-12G on May 30, 2014, which terminated the registration of its stock; and (3) between November 21, 2012, and May 30, 2014, CYIOS filed no required periodic reports. *See* Div. Ex. 2 at 40-41, 77; Div. Ex. 21 at 513; CYIOS Form 15-12G filed May 30, 2014; CYIOS Form S-8 filed November 29, 2007. Accordingly, CYIOS violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13. The record also shows that Carnahan was responsible for CYIOS' periodic filings, and knew that CYIOS was not filing them. *E.g.*, Div. Ex. 2 at 40-41, 58, 60, 77. Thus, Carnahan caused CYIOS' violations. Moreover, Carnahan purposefully decided to stop making CYIOS' periodic filings; insofar as his state of mind bears on any remedial sanction against him and CYIOS, he clearly acted in deliberate disregard of a regulatory requirement. *See id.*; Answer at 4 ("CYIOS was having financial hardship and was not able to continue paying for auditors and lawyers for the filings").

C. Carnahan Violated Exchange Act Rules 13a-14 and 13a-15

Exchange Act Rule 13a-15(c) states that the management of an issuer required to file annual reports pursuant to Exchange Act Section 13(a) must evaluate the effectiveness of the issuer's ICFR as of the end of each fiscal year. 17 C.F.R. § 240.13a-15(c). Exchange Act Rule 13a-14(a) states that Forms 10-K and 10-Q must include specified certifications signed by the issuer's principal executive and principal financial officer. *See* 17 C.F.R. § 240.13a-14(a). One such certification is that the report "does not contain any untrue statement of material fact." 17 C.F.R. § 229.601(b)(31)(i). Rule 13a-14(a) is violated if a report contains materially false or misleading information. *See SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 315-16 (S.D.N.Y. 1975); *Russell Ponce*, 54 S.E.C. 804, 812 n.23, (2000), *pet. denied*, 345 F.3d 722 (9th Cir. 2003).

There is no evidence that Carnahan "assessed the effectiveness of [CYIOS' ICFR]" at any relevant time. Div. Ex. 21 at 505; *see* Div. Ex. 2 at 63-65, 72-75. He essentially testified that CYIOS' internal controls are sufficient because its data processing is effective. *See* Tr. 187. But CYIOS is accused of falsely asserting that it assessed ICFR using the COSO framework, not just that it lacked ICFR. *See* OIP at 4-5. In any event, CYIOS' ICFR has gaping holes, which suggests it has never been assessed. *See* Tr. 213 ("Q[uestion by Carnahan]: The human resources – we don't have a human resources control. A[nswer from Lundelius]: Need I say more."); Div. Ex. 2 at 72 ("I am the internal control"). Carnahan asserted in his post-hearing brief that he evaluated CYIOS' ICFR "for each 10-K and 10-Q," and, apparently, that CYIPRO constitutes the documentation of those evaluations. Carnahan Br. at 6. But there is no evidence (as opposed to argument) that CYIPRO "was built with ICFR and COSO in mind." *Id.*; *see* Div Ex. 3 at 100; Resp. Ex. 3. Rather, he essentially conceded in his post-hearing brief that he did

not use the COSO framework for CYIOS' ICFR assessments. *See* Carnahan Br. at 6 ("ISO 9000:2008 is a recognized standard . . . [and] we do not have to use COSO but something similar"). Indeed, he does not appear to have even a rudimentary understanding of COSO, much less an understanding sufficient to use it to assess CYIOS' ICFR. *See, e.g.*, Tr. 212-13.

CYIOS' Forms 10-K for fiscal years 2009, 2010, and 2011, and its Forms 10-Q filed between first quarter 2010 and third quarter 2012, all stated that CYIOS management had assessed the effectiveness of its ICFR using the COSO framework. *E.g.*, Div. Ex. 13 at 310; Div. Ex. 21 at 505. All such statements were false and failed to comply with both Rule 13a-14 and Rule 13a-15. Because Carnahan signed and was responsible for the contents of CYIOS' periodic filings, he violated both Rule 13a-14 and Rule 13a-15. *See* Tr. 157-58; Div. Ex. 2 at 58, 60. Moreover, the contrast between Carnahan's complete failure to assess ICFR and the statements to which he attested in CYIOS' periodic filings was extreme, so much so that his statements were knowingly false. That is, Carnahan at least deliberately disregarded a regulatory requirement.

D. CYIOS Violated, and Carnahan Caused CYIOS' Violation of, Section 17(a)(3)

The OIP alleges that CYIOS violated Section 17(a) of the Securities Act, and Carnahan caused CYIOS' violations, by filing periodic reports that falsely stated that CYIOS had assessed ICFR and that falsely certified the accuracy of the reports. *See* OIP at 4-5. Securities Act Section 17(a)(2) proscribes obtaining money or property by means of an untrue statement of material fact. 15 U.S.C. § 77q(a)(2); *John P. Flannery*, Securities Act Release No. 9689, 2014 WL 7145625, at *11 (Dec. 15, 2014), *pet. granted and order vacated on other grounds*, --- F.3d ---, 2015 WL 8121647 (1st Cir. Dec. 8, 2015). Section 17(a)(3) proscribes transactions, practices, and courses of business that operate or would operate as a fraud, and proscribes misrepresentations only if they constitute fraudulent practices or courses of business. 15 U.S.C. § 77q(a)(3); *John P. Flannery*, 2014 WL 7145625, at *18. Thus, a single act of making a material misstatement, by itself, would not violate Section 17(a)(3), but repeatedly making material misstatements could constitute a fraudulent practice or course of business. *Id.* Section 17(a) also requires that the violative conduct be material, in the offer or sale of securities, and in interstate commerce. *See SEC v. Smart*, 678 F.3d 850, 856-57 (10th Cir. 2012).

Carnahan repeatedly and knowingly made misstatements in CYIOS' periodic filings, and the filings were transmitted to the Commission electronically using the internet, for public dissemination. *E.g.*, Div. Ex. 2 at 59-60 (describing "EDGARiz[ing]"). This is sufficient to demonstrate that CYIOS knowingly made repeated untrue statements in interstate commerce, and that Carnahan was a cause of those untrue statements.

Where the fraud alleged involves misstatements in public Commission filings "on which an investor would presumably rely, the 'in [the offer or sale]' requirement is generally met by proof of the means of dissemination and the materiality of the misrepresentation or omission." *SEC v. Wolfson*, 539 F.3d 1249, 1262 (10th Cir. 2008) (quoting *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993), and citing *Semerenko v. Cendant Corp.*, 223 F.3d 165, 176 (3d Cir. 2000); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1171 (D.C. Cir. 1978); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 861-62 (2d Cir. 1968) (en banc)); *cf. United States v. Naftalin*, 441

U.S. 768, 773 n.4 (1979) (noting that the Supreme Court has used Section 17(a)'s phrase "in" the offer or sale interchangeably with Exchange Act Section 10(b)'s phrase "in connection with"). Materiality is satisfied if there is a substantial likelihood that an accurate disclosure would have been viewed by a reasonable investor as having "significantly altered the total mix of information made available." *Matrixx Initiatives, Inc. v. Siracusano*, 536 U.S. 27, 38 (2011) (internal quotation marks omitted).

Because Carnahan "personally certified the false statements in this case, they can be seen as 'impugn[ing] the integrity of management,' which in itself would be material to investors." *In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132, 139 (S.D.N.Y. 2008) (alteration in original); *see United States v. Hatfield*, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010) ("It is well-settled that information impugning management's integrity is material to shareholders.") Lundelius opined that the effectiveness of ICFR is material because "the lack of effectiveness of internal controls calls into question the accuracy of an issuer's public disclosures." Div. Ex. 24 at 11. A failure to assess the effectiveness of ICFR would therefore also be material to investors.

As for the "in the offer or sale" requirement, the Division has proven that CYIOS' misstatements were made in periodic Commission filings, that CYIOS' stock was actively (if thinly) traded at all relevant times, and that CYIOS issued millions of shares of stock in 2010 alone. *See* Div. Ex. 12 at 277; *see generally* Div. Ex. 26. And again, Carnahan's statements regarding ICFR assessment were knowingly false. Taken as a whole, the record establishes that CYIOS violated Securities Act Section 17(a)(3), that Carnahan directed CYIOS' violation with the requisite state of mind, and that Carnahan therefore caused CYIOS' violation.

The record does not, however, establish a violation of Securities Act Section 17(a)(2). The Division argues that CYIOS obtained money or property in the form of consulting services. Div. Br. at 6-7. But consulting services are neither money nor property. The Division cites no authority squarely stating that a stock-for-services transaction meets the requirements of Section 17(a)(2), nor have I identified any such authority. *Id.* Certainly consulting services are valuable, but Section 17(a)(2) prohibits obtaining only two categories of valuable things by false or misleading statements. It does not clearly prohibit obtaining other valuable but intangible things, such as noncompete covenants, unassignable contracts, or, as here, professional services. *See Bressner v. Ambroziak*, 379 F.3d 478, 483 (7th Cir. 2004) (value of services did not constitute property); *cf. Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 555-57 (1993) (describing various intangible assets). Nor does the fact that CYIOS reported the stock-for-services transactions on its balance sheet and cash flow statements mean that the transactions involved money or property under Section 17(a)(2), any more than reporting, say, goodwill in financial statements means that goodwill constitutes money or property under Section 17(a)(2). *See* Div. Br. at 6-7. In short, CYIOS' false statements did not cause it to receive money or property in exchange for its stock.

IV. SANCTIONS

The Division requests cease-and-desist orders as to all three Respondents, disgorgement of $244,835.48 as to Anderson and $37,500 as to CYIOS, and either second- or third-tier civil penalties as to all three Respondents. Div. Reply at 4-6 & n.6; Div. Motion for Summary

Disposition at 14-16. The Division also requests a practice bar against Anderson. Division's Motion for Summary Disposition at 15-16. No sanction will be imposed on Anderson because she did not violate Sarbanes-Oxley Section 105(c)(7)(B).

A. The Public Interest

When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (*Steadman* factors). *See Altman v. SEC*, 666 F.3d 1322, 1329 (D.C. Cir. 2011); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009), *pet. denied*, 592 F.3d 173 (D.C. Cir. 2010). Other factors the Commission has considered include the age of the violation (*Marshall E. Melton*, 56 S.E.C. 695, 698 (2003)), the degree of harm to investors and the marketplace resulting from the violation (*id.*), the extent to which the sanction will have a deterrent effect (*see Schield Mgmt. Co.*, 58 S.E.C. 1197, 1217-18 & n.46 (2006)), whether there is a reasonable likelihood of violations in the future (*KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1185 (2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002)), and the combination of sanctions against the respondent (*id.* at 1192). *See also WHX Corp. v. SEC*, 362 F.3d 854, 859-61 (D.C. Cir. 2004). The Commission weighs these factors in light of the entire record, and no one factor is dispositive. *KPMG Peat Marwick LLP*, 54 S.E.C. at 1192; *see Gary M. Kornman*, 2009 SEC LEXIS 367, at *22.

Carnahan and CYIOS committed their violations, and Carnahan caused CYIOS' violations, repeatedly and over the course of years. Their Securities Act violations involved antifraud provisions, and were therefore egregious, as were their reporting violations. *See China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *10 (Nov. 4, 2013) (characterizing the failure to file any periodic reports in a year and a half as "serious"). They committed their violations deliberately. Carnahan has offered no credible assurances against future violations, has not recognized the wrongful nature of his conduct, and remains the control person of CYIOS. Although CYIOS is not presently an issuer that must file periodic reports, it continues to be publicly traded and Carnahan "[d]efinitely" would re-register CYIOS' stock if he can "get this thing straightened out." Tr. 192. The violations are recent, there is some concrete evidence of investor harm (because the consulting firm that became an investor in CYIOS by the stock-for-services transaction did not know that CYIOS' ICFR had not been properly evaluated), a heavy sanction will have both a general and a specific deterrent effect, and even the combination of multiple heavy sanctions would not be unfairly prejudicial. Most importantly, there is a reasonable likelihood of future violations; indeed, in view of Carnahan's alarming indifference to his legal obligations as the controlling officer of a publicly traded company, they are highly likely if CYIOS ever registers its securities again. Every public interest factor weighs in favor of a heavy sanction against Carnahan and CYIOS.

B. Cease-and-Desist Order

Exchange Act Section 21C and Securities Act Section 8A authorize the Commission to impose cease-and-desist orders for violations of those acts. *See* 15 U.S.C. §§ 77h-1(a), 78u-3(a). The Commission requires some likelihood of a future violation before imposing such an order. *KPMG Peat Marwick LLP*, 54 S.E.C. at 1185. However, "a finding of [a past] violation raises a sufficient risk of future violation," because "evidence showing that a respondent violated the law once probably also shows a risk of repetition that merits our ordering him to cease-and-desist." *Id.*

On balance, the relevant factors weigh in favor of cease-and-desist orders against Carnahan and CYIOS. Two of those factors – the recurrence of the violations and Carnahan's total lack of recognition of the wrongfulness of his and CYIOS' conduct – are particularly significant. The incremental prejudice to Carnahan and CYIOS arising from cease-and-desist orders, compared to the other sanctions, is minimal. Cease-and-desist orders on those Respondents will therefore be imposed.

C. Disgorgement

Disgorgement is authorized in this case by Exchange Act Sections 21B(e) and 21C(e) and Securities Act Section 8A(e). *See* 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e). Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). The amount of the disgorgement need only be a reasonable approximation of profits causally connected to the violation. *See Laurie Jones Canady*, 54 S.E.C. 65, 84 n.35 (1999) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *pet. denied*, 230 F.3d 362 (D.C. Cir. 2000). Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to Respondent to demonstrate that the Division's disgorgement figure is not a reasonable approximation. *Guy P. Riordan*, Securities Act Release No. 9085, 2009 WL 4731397, at *20 (Dec. 11, 2009), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010). The standard for disgorgement is but-for causation and has nothing to do with the public interest; in essence, disgorgement is always in the public interest because its purpose is "to ensure illegal actions do not yield unwarranted enrichment even to innocent parties." *Jay T. Comeaux*, Exchange Act Release No. 72896, 2014 WL 4160054, at *3, *5 & n.36 (Aug. 21, 2014). The combination of sanctions also does not affect disgorgement. *Id.* at *4 n.32.

The undisputed value of CYIOS' ill-gotten gains – namely, the consulting services it received in consideration for CYIOS stock – is $37,500. Tr. 68-70, 192-93; Div. Ex. 12 at 277; Div. Ex. 13 at 292, 303. The value of services performed by a respondent can offset ill-gotten gains, and, conversely, the value of services received by a respondent can constitute ill-gotten gains. *See Montford & Co.*, Investment Advisers Act of 1940 Release No. 3829, 2014 WL 1744130, at *23 (May 2, 2014), *pet. denied*, 793 F.3d 76 (D.C. Cir. 2015). CYIOS has not claimed an inability to pay, and it will therefore be ordered to disgorge $37,500. Tr. 197. The Division has not calculated the prejudgment interest, which will be ordered due from the first day of September 2014, the month after CYIOS' stock deregistration became effective. *See* 17

C.F.R. § 201.600(a). Interest shall continue to accrue on all disgorgement and prejudgment interest owed until they are paid. *Id*.

D. Civil Penalties

Under Exchange Act Section 21B(a)(2) and Section 8A(g)(1) of the Securities Act, the Commission may impose a civil money penalty if a respondent violated, or caused any violation of, any provision of the Exchange Act, and if such penalty is in the public interest. 15 U.S.C. §§ 77h-1(g)(1), 78u-2(a)(2). A three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b). Where a respondent's misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, the Commission may impose a "second-tier" penalty of up to $75,000 for each act or omission by an individual, and $375,000 for any other person, for violations occurring after March 3, 2009. 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2); 17 C.F.R. § 201.1004, Subpt. E, Table 4. Where a respondent's misconduct further directly or indirectly resulted in substantial pecuniary gain to the respondent or substantial losses to other persons, or created a significant risk of substantial losses to other persons, the Commission may impose a "third-tier" penalty of up to $150,000 for each act or omission by an individual or $725,000 for any other person. 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3); 17 C.F.R. § 201.1004, Subpt. E, Table 4.

The Division seeks third-tier penalties against Carnahan and CYIOS. Div. Br. at 9-10. The Division does not request a specific number of individual penalties, and to minimize the prejudice against them I assess only one "unit" of penalty against each of those Respondents. *Id*.

Carnahan and CYIOS qualify for second-tier penalties but not third-tier penalties. The gain to CYIOS from the stock-for-services transaction was not substantial, nor did the harm arising from CYIOS' misrepresentations to its investors ripen into substantial losses. And CYIOS' relatively small market capitalization, anemic trading volume, and low stock price rendered any risk of substantial losses insignificant. Carnahan earned a substantial income from CYIOS in 2010 and 2011, when CYIOS was disseminating false information about its ICFR evaluations. *See* Div. Ex 3 at 119. However, it is not clear that Carnahan's pecuniary gain resulted from misconduct rather than CYIOS' legitimate operations.

In determining whether a civil penalty is in the public interest, six factors are considered: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. § 78u-2(c). Within any particular tier, the Commission has discretion to set the amount of the penalty. *See Brendan E. Murray*, Investment Advisers Act of 1940 Release No. 2809, 2008 SEC LEXIS 2924, at *42 (Nov. 21, 2008); *The Rockies Fund, Inc.*, Exchange Act Release No. 54892, 2006 SEC LEXIS 2846, at *25 (Dec. 7, 2006). "[E]ach case has its own particular facts and circumstances which determine the appropriate penalty to be imposed" within the tier. *SEC v. Murray*, No. OS-CV-4643, 2013 WL 839840, at *3 (E.D.N.Y. Mar. 6, 2013) (internal quotation marks and citations omitted); *see also SEC v. Kern*, 425 F.3d 143, 153 (2d Cir. 2005).

Maximum penalties against Carnahan and CYIOS are warranted. Although the proven harm to other persons was not substantial, and neither Carnahan nor CYIOS have a history of regulatory violations, they acted deceitfully, they have made no prior restitution, and there is a strong need for both specific and general deterrence. Carnahan's desire to re-register CYIOS' stock and his obliviousness to his duties, given the lack of an officer-and-director bar, also weigh in favor of the maximum civil penalty. Carnahan and CYIOS will therefore be ordered to pay civil penalties of $75,000 and $375,000, respectively.

E. Inability to Pay

Carnahan plainly has a sufficient net worth to pay a civil penalty of $75,000, even accepting his testimony that he is the guarantor of at least some of CYIOS' debt. *See generally* Div. Ex. 29; *see* Tr. 195-96. No sworn financial statement has been submitted establishing CYIOS' inability to pay. Tr. 197.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on November 9, 2015.

VI. ORDER

It is ORDERED that this proceeding is DISMISSED as to Traci J. Anderson.

It is FURTHER ORDERED, pursuant to Section 21C of the Securities Exchange Act of 1934, that Respondent CYIOS Corporation shall CEASE AND DESIST from committing any violations or future violations of Section 13(a) of the Securities Exchange Act of 1934 and Rules 13a-1 and 13a-13 thereunder, and Respondent Timothy W. Carnahan shall CEASE AND DESIST from causing any violations or future violations of Section 13(a) of the Securities Exchange Act of 1934 and Rules 13a-1 and 13a-13 thereunder.

It is FURTHER ORDERED, pursuant to Section 21C of the Securities Exchange Act of 1934, that Respondent Timothy W. Carnahan shall CEASE AND DESIST from committing any violations or future violations of Rules 13a-14 and 13a-15 under the Securities Exchange Act of 1934.

It is FURTHER ORDERED, pursuant to Section 8A of the Securities Act of 1933, that Respondent CYIOS Corporation shall CEASE AND DESIST from committing any violations or future violations of Section 17(a)(3) of the Securities Act of 1933, and Respondent Timothy W. Carnahan shall CEASE AND DESIST from causing any violations or future violations of Section 17(a)(3) of the Securities Act of 1933.

It is FURTHER ORDERED, pursuant to Section 8A of the Securities Act of 1933, that Respondent CYIOS Corporation shall DISGORGE $37,500.00, plus prejudgment interest on that

amount, calculated from September 1, 2014, to the last day of the month preceding the month in which payment of disgorgement is made, consistent with 17 C.F.R. § 201.600.

It is FURTHER ORDERED, pursuant to Section 21B of the Securities Exchange Act of 1934 and Section 8A of the Securities Act of 1933, that Respondent CYIOS Corporation shall pay a CIVIL MONEY PENALTY of $375,000.00 and Respondent Timothy W. Carnahan shall pay a CIVIL MONEY PENALTY of $75,000.00.

Payment of disgorgement, prejudgment interest, and civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order shall include a cover letter identifying the Respondent and Administrative Proceeding No. 3-16386, and shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Cameron Elliot
Administrative Law Judge