

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 87484 / November 7, 2019

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4101 / November 7, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of

David Pruitt, CPA,

Respondent.

**ORDER MAKING FINDINGS AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-AND-
DESIST ORDER PURSUANT TO SECTION 21C
OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

On April 28, 2017, the Securities and Exchange Commission (“Commission”) instituted administrative and cease and desist proceedings pursuant to Sections 21C and 4C of the Securities Exchange Act of 1934 (“Exchange Act”) against David N. Pruitt (“Pruitt” or “Respondent”).

II.

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, and except as provided herein in Section V, Respondent consents to the entry of this Order Pursuant to Section 21C of the Exchange Act, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

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

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

A. SUMMARY

1. These proceedings arise out of L3 Technologies, Inc.'s (formerly known as L-3 Communications Holdings, Inc.) ("L3") premature, and thus improper, recognition of \$15.45 million in revenue at its Army Sustainment Division ("ASD") subsidiary in 2013 and Q1 2014. The revenue was related to unbilled items under a fixed-price aircraft maintenance contract between ASD and the U.S. Army, referred to as the C-12 Contract.

2. The unbilled items had been identified as part of a Revenue Recovery Initiative that had begun in August 2013. In late December 2013, Pruitt—Vice President of Finance at ASD—instructed a subordinate to generate 63 invoices related to the unbilled work in L3's internal accounting system ("SAP"), and withhold delivery of those invoices from the U.S. Army's electronic billing system until they were hand-delivered to the U.S. Army for approval. However, other than a handful of invoices that were delivered to the U.S. Army in early 2014, the vast majority of these invoices were not submitted to the U.S. Army. By entering the invoices in SAP but not ensuring their delivery, collectability could not be reasonably assured, as required under ASC 605, and ASD improperly recognized approximately \$17.9 million in additional revenue at the end of 2013, and in Q1 2014.

3. Following an internal investigation, on October 10, 2014, L3 filed a Form 10-K/A for the fiscal year ended December 31, 2013, and a Form 10-Q/A for the first quarter of 2014. Among other things, L3 disclosed that it made \$15.4 million in adjustments to pre-tax income related to the revenue recovery invoices by reversing the revenue from the invoices, and recording the related costs as assets on its balance sheet.

B. RESPONDENT

4. Pruitt, 63 years old, is a resident of Owens Cross Roads, AL. Pruitt began working for L3 in 2003 and served as the VP of Finance for ASD from January 2013 until January 2014. In January 2014, he was reassigned to the position of Senior Director of Finance for Army Fleet Support at ASD, and served in that role until his termination from L3 on July 30, 2014. Pruitt is a certified public accountant ("CPA") (licensed in Kentucky), certified management accountant, certified government financial manager, and certified defense financial manager.

C. OTHER RELEVANT ENTITY

5. L3 (NYSE ticker: LLL), a Delaware corporation with its principal place of business in New York, NY, is a prime contractor for various foreign and U.S. Government agencies, including the U.S. Department of Defense. L3's securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act. L3 is a prime contractor in aerospace systems and national security solutions. For fiscal year 2013, L3 reported net sales of \$12.6 billion and an operating income of \$1.2 billion on its consolidated statements of operations.

D. BACKGROUND

6. Aerospace Systems is one of four business segments of L3, delivering integrated solutions for the global intelligence market and providing maintenance and logistics support for a

wide variety of aircraft and ground systems. Each business segment is comprised of multiple business “sectors,” and each business sector is comprised of multiple business “divisions.” Of relevance to this matter are the Logistics Solutions sector of Aerospace Systems, which provides, among other things, logistics support and aircraft maintenance services to its military customers, and ASD, a subsidiary of Logistics Solutions, which provides support for U.S. Army aircraft at bases throughout the United States and around the world.

7. L3, through its subsidiary Vertex Aerospace, LLC (“Vertex”), and later ASD, contracted to maintain a fleet of over 160 fixed-wing C-12 airplanes for the U.S. Army pursuant to the C-12 Contract. The contract had a five-year term, commencing on June 2, 2010, and ending on January 31, 2015, with the partial initial year referred to as a “base year,” and each subsequent year referred to as an “option year.” ASD was formed at the beginning of 2013, in part to take over the C-12 Contract from Vertex, and improve L3’s performance under the contract. ASD, along with Pruitt and others, worked through 2013 to resolve various issues with the C-12 Contract.

E. THE REVENUE RECOVERY INITIATIVE AND LEGAL ENTITLEMENT

8. In the summer of 2013, Pruitt and the President of ASD (“ASD President”) learned that ASD had unaccounted for costs related to previously performed work for the U.S. Army on its balance sheet related to the C-12 Contract in the range of \$30 to \$35 million. The business manager on the C-12 contract (the “C-12 Business Manager”) believed the growth in that particular balance was a result of cost overruns that would result in a large loss to ASD. The C-12 Business Manager informed Pruitt of the costs, and prepared him for a meeting with the ASD President and the President of Logistics Solutions—the corporate parent of ASD—to discuss the potential loss.

9. On or about September 20, 2013, Pruitt, the ASD President, and the C-12 Business Manager reported to the President of Logistics Solutions that they had identified a growing work in progress (“WIP”) balance on ASD’s books arising from the C-12 Contract, and that the Division may need to write off some of the WIP (approximately \$8-9 million). The report angered the President of Logistics Solutions, and he asked members of ASD to re-check their numbers and verify that it was true. The President of Logistics Solutions also directed ASD to determine what work the WIP balance related to, and asked Respondent, the ASD President, and other members of ASD to determine how to bill it to the U.S. Army. The President of Logistics Solutions requested weekly meetings—and later, daily meetings—with ASD officers and C-12 program management, including the ASD President and Respondent, to obtain a better understanding of the WIP balance. Respondent and the ASD President were in constant communication with each other from September to December 2013 concerning the status of the review.

10. The ASD President directed the C-12 Contract team at ASD to review the contract in detail to determine if there were items not billed to the Army that should have been billed. This became known as the Revenue Recovery Initiative. By mid-November 2013, the director of the C-12 Contract (“C-12 Director”) identified approximately \$50.6 million in work performed by ASD under the contract that was not billed to the U.S. Army. The \$50.6 million value was comprised of nine different work stream items and costs under the C-12 Contract.

11. During the fall of 2013, the focus of the Revenue Recovery Initiative turned to identifying ways to recognize revenue on the unbilled \$50.6 million. Based on the President of Logistics Solutions' words and conduct, Respondent and the ASD President believed that the President of Logistics Solutions expected ASD to either recognize revenue or defer the costs associated with the \$50.6 million revenue recovery items by the end of 2013. On November 8, 2013, the President of Logistics Solutions sent an email (copying Respondent) directing the ASD President to "please identify with coordination with [Respondent and CFO of the Aerospace Systems segment ("Aerospace Systems CFO")] the C-12 Army accounting to be used for Q4, specifically, which costs will be deferred related to the unbilled items, and take this accounting into consideration on your LRE [i.e. latest revised estimate] so we know where we expect to get to in EBIT [Earnings Before Interest and Taxes] for 2013."

12. Also during the fall of 2013, certain individuals at Logistics Solutions and ASD began discussing the possibility of recognizing revenue on some of the \$50.6 million in unbilled items based on a concept called "legal entitlement," even though the amounts had not been resolved with the Army. Respondent and the ASD President both participated in discussions concerning the recognition of revenue based on legal entitlement.

13. On November 22, 2013, there was a conference call among Respondent, the Aerospace Systems CFO, and others to discuss certain options for how to record revenue pursuant to legal entitlement. The Aerospace Systems CFO recalled that the task was for the C-12 Contract experts—i.e., the General Counsel of ASD and the General Counsel of Logistics Solutions—to find clauses in the C-12 Contract that entitled ASD to payment, show that the government did not follow its obligations under the clauses, determine what to submit as a request for equitable adjustment ("REA"), and estimate based on the contract's history how much the Army would pay. REAs were formal methods under the C-12 Contract by which ASD could request an equitable adjustment to the funding amounts for each Contract Line Item ("CLIN"), although the U.S. Army also resolved certain billing disputes without resorting to REAs.

14. At Respondent's request, the General Counsels of ASD and of Logistics Solutions estimated that ASD was likely to recover approximately \$30 million of the entire \$50.6 million, based on their history of negotiations with the government. Between Thanksgiving and December 5, 2013, Pruitt asked the General Counsels of ASD and of Logistics Solutions to prepare letters of legal entitlement that would be used to support the revenue recognition.

15. On December 3, 2013, the ASD President presented an operations review regarding ASD to the President of Logistics Solutions. Included was a slide entitled, "Army C-12 Contract Dispute Summary," which listed a table of ten rows with separate "REA/Claim Values" adding up to \$50.6 million. A column on the table was entitled "Legal Entitlement" and applied a percentage of either 50% or 60% to each claim value that comprised the \$50.6 million. The presentation also included detailed slides on six of the claims, and noted that ASD planned to meet with the government to reach an amicable resolution and that, "[a]fter the negotiations with the government, L3 is postured to immediately invoice and bill the government."

16. The revenue recovery items were presented by Logistics Solutions and ASD to the U.S. Army in meetings that took place in late November and early December 2013. On December 5, 2013, the C-12 Director and the General Counsel of ASD met with representatives of the U.S.

Army to discuss the C-12 Contract disputes. An email from the C-12 Director to the President of Logistics Solutions reporting on this meeting indicates that the U.S. Army planned to meet internally on December 17, 2013, and begin meeting with L3 after the new year with the “intent [] to resolve every one of the disputes outside of the REA/Claim process... as quickly as possible.” The e-mail further stated that, “the government was offended by [ASD’s] use of the term REA [and] . . . understands our mutual intent to work amicably to resolve every issue . . . as quickly as possible.” In a later e-mail in December 2013, certain representatives of the Army “recommend[ed] L3 submit invoices/billing/justification of payment thru the appropriate channels,” and indicated that “[o]nce these have been submitted, the government will pay the bill as they do with all other work if justified.” Respondent did not expect L3 to reach an agreement with the U.S. Army concerning the amount of revenue recovery items the U.S. Army would pay before the end of 2013.

F. GENERATION OF INVOICES AND IMPROPER REVENUE RECOGNITION

17. Respondent and the Aerospace Systems CFO had a telephone call on or about Friday, December 20, 2013. Respondent and the Aerospace Systems CFO discussed a one-page list of the revenue recovery items that he emailed the Aerospace Systems CFO prior to the call. Pruitt and the Aerospace Systems CFO went down the list and the Aerospace Systems CFO instructed Pruitt which items to invoice and which to accrue. The Aerospace Systems CFO claimed he did not give Pruitt blanket authority to invoice for the items, but does recall a conversation in which he told Pruitt that he could invoice for work performed during option year 3 (i.e., 2013).

18. On Monday, December 23, 2013, Respondent emailed the C-12 Business Manager “billing amounts” for seven of the revenue recovery items to begin the invoicing process. The C-12 Business Manager emailed ASD’s Controller, copying the C-12 Director and Respondent, asking the individual to “[p]lease add planned revenue . . . for the revenue recovery billings that I did today,” and further stating, “I believe the current course of action is that they are not to be released to the government.”

19. Respondent instructed the C-12 Business Manager not to submit the invoices electronically through the U.S. Army’s Wide Area Work Flow (“WAWF”) electronic billing system, and ASD recognized an additional \$15.45 million in revenue at the time based on the undelivered invoices. It was unreasonable for Respondent to generate invoices causing the recognition of revenue because L3 and the U.S. Army had not completed negotiations regarding payment for the unbilled work.

G. L3’s INVESTIGATION OF IMPROPER ACCOUNTING

20. In June 2014, L3 investigators discovered that the vast majority of the invoices had not been delivered to the U.S. Army.

21. Accounting Standards Codification 605-10-25-1 provides that revenue can be recognized when it is realized or realizable and earned. Consistent with the authoritative literature, paragraph (A)(1) of the Codification of Staff Accounting Bulletins, Topic 13: Revenue Recognition (which provides guidance on the C-12 Contract) states (“Topic 13(A)(1)”) that

collectability be reasonably assured as a condition to recognizing revenue. By failing to deliver the invoices, ASD's recognition of the \$15.45 million in revenue did not comply with this standard and therefore did not comply with U.S. GAAP.

22. L3 filed its Form 10-K for the fiscal year ending December 31, 2013 on February 25, 2014 and its Form 10-Q for the quarter ending March 31, 2014 on May 1, 2014. These filings were inaccurate, and L3 revised them following its internal investigation.

H. L3's REVISED FINANCIAL STATEMENTS

23. On October 10, 2014, L3 filed a Form 10-K/A for the fiscal year ended December 31, 2013, and a Form 10-Q/A for the first quarter of 2014. Among other things, L3 reversed the revenue related to the invoices and recorded the related costs as assets on its balance sheet. In subsequent public filings, L3 disclosed that it recovered \$30 million dollars from the U.S. Army for cost overruns on the C-12 contract which included recovery for items that were invoiced as part of the Revenue Recovery Initiative.

I. VIOLATIONS

24. As a result of the conduct described above, Respondent caused L3's violations of Section 13(b)(2)(A) of the Exchange Act, which requires an issuer to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

25. As a result of the conduct described above, Respondent violated Rule 13b2-1 of the Exchange Act, which prohibits any person from, directly or indirectly, falsifying or causing to be falsified, any book, record, or account that the Exchange Act requires an issuer to maintain.

IV.

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

Accordingly, pursuant to 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease-and-desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) of the Exchange Act and Rule 13b2-1 thereunder.

B. Respondent shall, within 120 days of the entry of this Order, pay a civil money penalty in the amount of \$25,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

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

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

Payments by check or money order must be accompanied by a cover letter identifying Pruitt as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Director, Division of Enforcement, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281.

Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree

or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Vanessa A. Countryman
Secretary