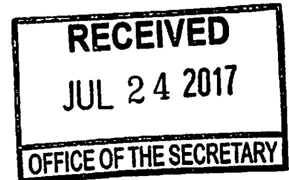
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of,

David Pruitt, CPA.

Respondent.



MEMORANDUM OF LAW IN OPPOSITION TO
<u>RESPONDENT'S MOTION FOR A RULING ON THE PLEADINGS</u>

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PRELIMINARY STATEMENT

The Division has alleged that in December 2013, Respondent David Pruitt generated 69 fictitious invoices in L3 Technologies, Inc.'s ("L3") internal accounting system in order to unlawfully recognize $17.9 million in revenue, which triggered a $62,100 bonus for Respondent. As an initial step in a protracted effort to conceal his serious misconduct, Respondent ordered his subordinates to disregard basic accounting principles and L3's safeguards against improper revenue recognition – internal accounting controls that require invoices to be delivered to the customer at the time they are generated (among other internal accounting controls). Respondent's scheme – facilitated by his deceitful emails not only to L3's corporate office but also to its external auditor – was brought to light in July 2014 following an extensive internal investigation by L3, which resulted in L3, a prime defense contractor doing business with the U.S. Armed Forces, revising its financial statements and terminating Respondent for cause.

It is a basic principle of accounting that revenue cannot be recognized based on invoices that are hidden from a customer, particularly if the customer is not even aware of the amounts contained within those invoices. But that is precisely what Respondent did, as clearly and adequately alleged in the OIP.

Based solely on cherry-picked legislative history and a carefully edited quote from a 1981 policy statement about a purported "*de minimis* exemption," Respondent asks the Court to hold, as a matter of law, that the books and records provisions of the securities laws permit someone such as Respondent – who is licensed as a CPA and was the principal accounting officer of a corporate division of a publicly traded company – to knowingly falsify books and records to the magnitude of $17.9 million. But this is *precisely* the type

of conduct that Congress – as well as the Commission – sought to address through the enactment of Sections 13(b)(2)(A) and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 13b2-1 thereunder.[1]

Although Respondent attempts to reduce the "reasonable detail" element under Section 13(b)(2)(A) of the Exchange Act to a simplistic arithmetic calculation, the plain language of the statute, legislative history, and Commission guidance make clear that the inquiry should consider all relevant facts and circumstances, including whether the misstatement occurred as a result of knowing misconduct. This conclusion would be obvious even based on the sentence from former Chairman Williams's speech upon which Respondent rests his entire argument, if Respondent had not omitted the last six words of that sentence from his quote. *Compare* Exchange Act Release No. 17500, 1981 WL 36385, at *5 (Jan. 29, 1981) ("In essence, therefore, the Act does provide a *de minimus* [sic] exemption, **though not in absolute, quantitative terms.**") (emphasis added) *with* Respondent's Br. at 5 ("[T]he 'in reasonable detail' language of Section 13(b)(2)(A) 'does provide a *de minimus* [sic] exemption' to the accuracy requirement."). But regardless of whether the standard is quantitative or qualitative (or a combination of both), the OIP is replete with allegations to satisfy the reasonableness element of the books and records charges.

Respondent also asks the Court to dismiss the internal controls charges based on the incorrect assertion that the OIP fails to identify an internal accounting control that requires L3 to distribute invoices to customers when the invoices are generated. This argument

[1] *See, e.g.*, S. Rep. No. 95-114, at 7 (1977) ("The purpose of [the accounting provisions] is to strengthen the accuracy of the corporate books and records and the reliability of the audit process which constitute the foundations of our system of corporate disclosure.").

ignores the well-pled allegations in the OIP, as well as the fact that the Division has identified sixteen accounting controls that are relevant to the internal controls charge.

Although Respondent attached excerpts from L3's internal controls in support of his motion, Respondent failed to discuss the specific control that contains this distribution requirement. Indeed, Invoicing and Receivable Control 4 ("IR 4") provides, in relevant part, that "[t]he Finance Department posts each invoicing transaction upon its preparation and distribution to the customer . . . ." Affidavit of Margaret E. Hirce ("Hirce Aff."), Ex. A, L3-DOJ-SEC-0000478755. Respondent makes no attempt to square the plain language of IR 4 with his argument that "there was simply no control that required delivery of invoices." *See* Respondent's Brief at 9.

Respondent further attempts to obfuscate the requirements of this control by failing to provide the Court with the Process Narrative – circulated by Respondent himself to the leadership team of the division he served as the principal accounting officer for (the Army Sustainment Division, or "ASD") – that contains specific and detailed guidance regarding how to comply with IR 4's distribution requirement. That document provides that "once an invoice is deemed good . . . **the Billing Clerk will then distribute the invoice to the customer [through] Wide Area Work Flow ("WAWF") . . . Fax [, or] Mail.**" *See* Decl. of H. Gregory Baker, Esq. ("Baker Decl."), Ex. A, L3-DOJ-SEC-0000244783 (emphasis added). In light of the clear requirements of this control, the OIP's allegations that Respondent directed his subordinates to generate 69 fictitious invoices and withhold them from the U.S. Army easily satisfy the applicable pleading standards under Rule 250. Respondent's motion should therefore be denied in its entirety.

STATEMENT OF FACTS

Respondent began working for L3 in 2003, and served as the Vice President of Finance for ASD from January 2013 until January 2014. OIP ¶¶ 4, 16. In January 2014, Respondent was demoted and reassigned to a different position based on performance issues, and was fired from L3 on July 30, 2014. *Id.* Respondent is a CPA, certified management accountant, certified government financial manager, and certified defense financial manager. OIP ¶ 4.

ASD was formed at the beginning of 2013, in large part to manage the C-12 Contract. *Id.* In the summer of 2013, Respondent and the President of ASD learned that ASD had unaccounted for costs on its balance sheet related to the C-12 Contract initially thought to be in the range of $30 to $35 million. OIP ¶ 8. During September 2013, Respondent and the ASD President realized that ASD would not likely meet its annual operating plan EBIT (Earnings Before Interest and Taxes), and it was also evident at the time that ASD was at risk of falling below the required EBIT threshold (i.e., 75% of plan) necessary for management personnel – including Respondent – to receive incentive bonuses. OIP ¶ 9.

By mid-November 2013, ASD identified approximately $50.6 million in work performed under the contract that was not billed. OIP ¶ 10. Around that time, certain individuals, including Respondent, began discussing the possibility of recognizing revenue on some portion of the $50.6 million (the "Revenue Recovery Claims") based on a concept called "legal entitlement," even though these claims had not been raised with the U.S. Army. OIP ¶ 12. The Revenue Recovery Claims were presented by ASD to the U.S. Army in meetings that occurred between late November and early December 2013. OIP ¶

19. As a result of these discussions, Respondent knew that these claims would not be resolved until 2014. *Id.*

In late December 2013, Respondent asked the C-12 Business Manager to explain how revenue was recorded on ASD's books. OIP ¶ 20. The C-12 Business Manager told Respondent that it was either billed or accrued. *Id.* Respondent subsequently asked him at what point revenue was recognized. *Id.* With respect to the unresolved claims concerning the C-12 Contract, the C-12 Business Manager explained that a sales order must be created and then released to the Billing Clerk. *Id.* The Billing Clerk then generated an invoice in SAP (L3's internal accounting software), at which point revenue was recognized. *Id.* The invoice was then submitted into WAWF, which automatically transmits invoices to the U.S. Army. *Id.*

On December 23, 2013, Respondent emailed the C-12 Business Manager "billing amounts" for seven revenue recovery items. OIP ¶ 22. The C-12 Business Manager emailed ASD's Controller, copying the C-12 Contract Manager 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." *Id.*

At Respondent's direction, Vertex finance staff[2] generated 69 invoices in SAP but withheld them from WAWF, causing ASD to recognize approximately $17.9 million in revenue, without delivery of the invoices to the Army. OIP ¶ 23. Prior to generating the invoices, the Vertex finance staff recognized that this practice was unusual and consulted

[2] Like ASD, Vertex was a division within Logistics Solution. To physically generate the invoices, ASD had to seek the assistance of Vertex because ASD's invoicing specialist was out of the office. OIP ¶ 23.

with the Controller of Vertex for guidance. *Id.* The Controller of Vertex called Respondent, who said that based on an agreement with the U.S. Army, ASD and the U.S. Army were going to negotiate each invoice before submitting them through WAWF. The Controller of Vertex was appeased by this conversation. *Id.*

Respondent explained, as the C-12 Contract Manager later wrote in a report to L3's ethics office on December 31, 2013, that:

> [I]nvoicing in SAP with no immediate intent to extend the invoice to the Government was a "technique" to utilize since New York had forbid [ASD] to accrue the designated Army C-12 Revenue Recovery amounts. This technique had the same year and effect on the financials that accrual would have had—potentially up to $18M revenue and associated EBIT recognition. I asked [Respondent] if this "technique" was known to and approved by New York. [Respondent] answered that he did not know, but that Group had directed him to take this path. I asked if we had this direction in writing and the answer was no.

OIP ¶ 25.

In that same December 31, 2013 email, the C-12 Contract Manager also reported on another conversation with Respondent, stating:

> Yesterday in a conversation with [the C-12 Business Manager] and the [ASD Controller] over year end close outs, [Respondent], according to the [C-12 Business Manager], stated that the Army C-12 year end numbers needed to be whatever they had to be in order for Division to make $40M EBIT. I'm sure [Respondent] meant something other than how the comment was taken. However, we, and especially the CFO, need to be careful with what we say—in particular in this current environment.

OIP ¶ 26.

Because of the $17.9 million in revenue from the invoices, ASD met the 75% of plan required to earn bonuses. OIP ¶ 27. Respondent received a bonus of $62,100 (later rescinded by L3) on a base salary of $189,673. *Id.*

In 2014, Respondent actively concealed his misconduct from L3's corporate office and external auditor on several occasions. In January, the Controller's office at L3

corporate requested that ASD obtain a letter from the U.S. Army indicating that ASD had permission to bill for certain of the Revenue Recovery Claims. OIP ¶ 30. When Respondent received a draft response from the U.S. Army, Respondent asked the General Counsel of ASD to delete a sentence that stated "[i]t would be an exercise in futility to submit invoices for these requested contract funding adjustments at this point, as they would be rejected . . . ." OIP ¶ 35. When the General Counsel refused to comply with Respondent's request, Respondent and the President of ASD asked him to obtain a revised version from the U.S. Army, which deletes the "exercise in futility" sentence. *Id.* The Army agreed and sent a new e-mail to the General Counsel of ASD removing the "exercise in futility" sentence, which was forwarded to L3's corporate office. *Id.* Based on the e-mail exchange between ASD and the U.S. Army, L3's auditor believed (incorrectly) that the Army was actively reviewing the invoices outside of the WAWF. *Id.*

Respondent also misled L3's external auditor on two additional occasions. First, on January 14, in response to the auditor's request for "acceptance document or proof of cash receipt as proof of the billing" for the C-12 Revenue Recovery Claims, Respondent prepared an explanation that omitted the fact that he directed that ASD not actually bill (i.e., invoice) the U.S. Army for these items. OIP ¶¶ 31-32. Respondent's misleading statement gave L3's auditor comfort that the invoices in question were presented to the U.S. Army. OIP ¶ 32.

Second, in April 2014, L3's auditor asked for an explanation regarding an $18.5 million growth in ASD's accounts receivable balance from Q1 2013 to Q1 2014. OIP ¶ 37. Respondent drafted an explanation – which was communicated to L3's auditor – that incorrectly suggested that the invoices had already been delivered to the U.S. Army. OIP

¶¶ 37-38. Also, Respondent's explanation included a statement that "[t]he USG has requested extensive documentation beyond the normal requirements to complete their review," which was misleading because the U.S. Army could not perform due diligence on claims that were not submitted. *Id.*

In June 2014, L3 investigators discovered the hard copy invoices on a shelf in a billing clerk's office. OIP ¶ 39. The invoices, which related to claims the U.S. Army had not agreed to pay, had not been delivered to the U.S. Army, in violation of a specific internal control that required delivery of invoices. *Id.*

As a result of Respodent's conduct, L3 improperly reported an additional $17.9 million in revenue in its Form 10-K filed with the Commission as of December 31, 2013, and in its Form 10-Q filed with the Commission as of March 31, 2014. OIP ¶¶ 37, 40-41. 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 the first quarter of 2014 correcting, among other errors, the $17.9 million that Respondent unlawfully recorded. OIP ¶ 42.

<u>ARGUMENT</u>

I. THE STANDARDS GOVERNING RULE 250(a) MOTIONS

On a motion for a ruling on the pleadings, the Court must "accept[] all of the non-movant's factual allegations as true and draw[] all reasonable inferences in the non-movant's favor." 17 C.F.R. § 201.250(a) (2016). The rule is analogous to Federal Rules of Civil Procedure 12(b)(6) and 12(c), which respectively provide for motions to dismiss for failure to state a claim and for judgment on the pleadings. *See* Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50212, 50224 n.110 (July 29, 2016). A motion for a ruling on the pleadings must be based only on the pleadings, matters subject to

official notice, matters of public record, and documents attached to, or incorporated by reference in, the OIP or answer. *Adrian D. Beamish, CPA*, Admin. Proc. Rulings Release No. 4504, 2017 WL 1175585, at *1 (ALJ Jan. 6, 2017).

II. THE OIP'S ALLEGATIONS EASILY SATISFY THE REASONABLENESS STANDARD OF SECTION 13(b)(2)(A)

Respondent caused ASD to record $17.9 million in revenue in violation of generally accepted accounting principles and L3's corporate accounting policies. Based on this conduct, the OIP charges Respondent with violating Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, and causing L3's violations of Section 13(b)(2)(A).

Section 13(b)(2)(A) requires companies with a class of securities registered pursuant to Section 12 of the Exchange Act to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions . . . of the issuer." Exchange Act § 13(b)(2)(A). To establish that a respondent caused a violation of Section 13(b)(2)(A), the Commission must show that: (1) a primary violation occurred; (2) an act or omission by the respondent was a cause of the violation; and (3) the respondent knew or should have known that his or her conduct would contribute to the violation. *Robert M. Fuller*, Exchange Act Release No. 8273, 80 SEC Docket 2748 (Aug. 25, 2003).

Exchange Act Rule 13b2-1 provides "[n]o person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A) of the Securities Exchange Act." 17 C.F.R. § 240.13b2-1. Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls, or knowingly falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. Exchange Act § 13(b)(5).

Materiality is not an element of a claim under Sections 13(b)(2)(A) or 13(b)(5), or

Rule 13b2-1. *SEC v. Stanard*, No. 06 Civ. 7736, 2009 WL 196023, at *29-30 (S.D.N.Y. Jan. 27, 2009); *SEC v. World-Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 749-50 (N.D. Ga. 1983). Additionally, no showing of scienter is required to establish a violation of Section 13(b)(2)(A) or Rule 13b2-1. *See SEC v. Das*, 723 F.3d 943, 954, 956 n.13 (8th Cir. 2013); *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998). "Rather, 'liability is predicated on standards of reasonableness.'" *SEC v. Espuelas*, 905 F.Supp.2d 507, 525-26 (S.D.N.Y. 2012) (quoting *SEC v. Softpoint*, 958 F. Supp. 846, 866 (S.D.N.Y. 1997)).

Respondent's sole argument contesting the legal sufficiency of the books and records charges is that his "miniscule" (Respondent's Br. at 3) $17.9 million scheme did not cause L3's accounts to be inaccurate "in reasonable detail." *Id.* This argument, which is based almost entirely on a selective quotation from a policy statement, imposes a purely quantitative reasonableness standard that seeks to excuse Respondent from his $17.9 million accounting misconduct simply because L3 is a big company with substantial revenues.

A. Congress and the Commission Did Not Draft the Books and Records Provisions to Protect CPAs Who Knowingly Falsify Corporate Records

In enacting Section 13(b)(2)(A), Congress rejected the quantitative standard for assessing reasonableness that Respondent urges the Court to adopt. *See, e.g.*, H.R. Rep. No. 100-576, at 917 (1988) (Conf. Rep.) ("The conference committee adopted the prudent man qualification in order to clarify that the current standard does not connote an unrealistic degree of exactitude or precision. The concept of reasonableness of necessity contemplates the weighing of a number of relevant factors . . . ."); *World-Wide Coin*, 567 F. Supp. at 749 (noting that Congress rejected the view that "that inaccuracies involving small dollar amounts would not be actionable" and finding that liability is "not limited to

material transactions or to those above a specific dollar amount.").[3] Congress devoted an entire paragraph of Section 13(b) to memorializing its preference for a "prudent person" test, and defined "reasonable detail" as "such level of detail . . . as would satisfy prudent officials in the conduct of their own affairs." *See* Exchange Act Section 13(b)(7). It is telling that in a motion based almost exclusively on the "reasonable detail" element of Section 13(b)(2)(A), Respondent does not cite to – let alone analyze – the one provision that defines this term (i.e., Section 13(b)(7)).

Ignoring Congress's words and intent, Respondent relies heavily on a remark from then-Chairman Williams that the "in the reasonable detail" language in Section 13(b)(2)(A) "provide[s] a *de minimis* exemption." Respondent's Br. at 5. But had Respondent not omitted the last six words of Chairman Williams' sentence, Respondent's brief would have made clear that this purported *de minimis* exemption does not exist in "absolute, quantitative terms." *See* Exchange Act Release No. 17500, 1981 WL 36385, at *5 (Jan. 29, 1981). Chairman Williams's actual statement – as opposed to the carefully edited version offered by Respondent – is consistent with Congress's view of the reasonableness standard.[4]

Respondent cites to a provision of the Internal Revenue Code, a U.S. Pension Benefit Guarantee Corporation regulation, and a Commission regulation promulgated

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[3] In commenting on a predecessor bill to the Foreign Corrupt Practices Act, the Commission made clear that the books and records provisions should not "lead to the argument that falsifications or omissions below a certain dollar amount may be tolerated." Promotion of the Reliability of Financial Information, Exchange Act Release No. 13185, 1977 WL 174077, at *4 n.6 (Jan. 19, 1977).

[4] Chairman Williams also stated that "the Act does not establish any absolute standard of exactitude for corporate records." *See* Exchange Act Release No. 17500, 1981 WL 36385, at *6 (Jan. 29, 1981).

pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act in support of his argument that Section 13(b)(2)(A) contains a purely quantitative *de minimis* standard. Respondent's Br. at 5 n.12. But these provisions actually highlight the weakness of Respondent's argument. Significantly, unlike in Section 13(b)(2)(A), in each of Respondent's three examples, the numerical *de minimis* exemption is found within the text of the statute or regulation. *See* 26 U.S.C. § 1273(a)(3), I.R.C. § 1273 (section entitled "1/4 of 1 percent *de minimis* rule"); 29 C.F.R. § 4231.7 (defining "*de minimis* transfer" as "less than 3 percent of the fair market value"); 17 C.F.R. § 255 (Final Rule) (providing for 3% *de minimis* exemption to Dodd-Frank investment limit). As these regulations cited by Respondent demonstrate, when Congress (or the Commission) wants to provide a purely numerical *de minimis* exemption to an enforcement regime, it explicitly provides for such an exception in the relevant statute. Congress declined to do so in Section 13(b)(2)(A), instead opting for a reasonably prudent official standard.

Moreover, as applied to knowing misconduct – like the type the Division has alleged in the OIP – Congress's intent is clear: "The accounting provisions [sic] principal objective is to reach knowing or reckless conduct." Exchange Act Release No. 17500, 1981 WL 36385, at *2 (Jan. 29, 1981).[5] Consistent with Section 13(b)(2)(A)'s focus on knowing falsifications, a recent Staff Accounting Bulletin provides that in determining

[5] In enacting Section 13(b)(2)(A), Congress was guided by the following principles: "(1) books and records should reflect transactions in conformity with accepted methods of reporting economic events, (2) misrepresentation, concealment, falsification, circumvention, and other deliberate acts resulting in inaccurate financial books and records are unlawful, and (3) transactions should be properly reflected on books and records in such a manner as to permit the preparation of financial statements in conformity with [Generally Accepted Accounting Principles or "GAAP"] and other criteria applicable to such statements." *SEC v. e-Smart Techs., Inc.*, 82 F.Supp.3d 97, 108 (D.D.C. 2015), *appeal dismissed*, (Oct. 27, 2015) (quoting *World-Wide Coin*, 567 F. Supp. at 748 (N.D. Ga. 1983)).

whether books and records are inaccurate "in reasonable detail . . . [i]t is unlikely that it is ever 'reasonable' for registrants to record misstatements . . . - even immaterial ones - as part of an ongoing effort directed by or known to senior management for the purposes of 'managing' earnings." *See* Staff Accounting Bulletin No. 114, 100 SEC Docket 2182 (Mar. 7, 2011).

The plain text of Exchange Act Section 13(b), legislative history of the books and records provisions, and guidance from the Commission compel the conclusion that Section 13(b)(2)(A)'s "in reasonable detail" language was not intended to insulate from liability corporate executives who knowingly falsify books and records – whether to secure a bonus or for any other reason. By resting his argument for the applicability of a *de minimis* exception on the words "in reasonable detail," Respondent effectively concedes that the OIP states legally sufficient books and records claims for violations of Section 13(b)(5) and Rule 13b2-1, neither of which contain the "in reasonable detail" language. Respondent's motion to dismiss the books and records claims should therefore be denied.

B. Respondent's Conduct Was Unreasonable

Reasonably prudent officials do not generate sham invoices and order that those invoices be withheld from the customer. Under any standard of reasonableness – the relevant standard under Section 13(b)(2)(A) – the OIP asserts a legally and factually sufficient books and records case against Respondent.

In the OIP, the Division alleges that in December 2013, Respondent caused 69 invoices to be generated in L3's internal accounting system, and then ordered them to be withheld from the U.S. Army. OIP ¶ 2. The 69 invoices resulted in L3 prematurely and improperly recognizing $17.9 million in revenue, which L3 conceded when it revised its

financial statements. OIP ¶ 3. That unlawfully recognized revenue was based on unbilled costs, which Respondent knew the U.S. Army would not pay or even begin to consider until 2014. OIP ¶¶ 8, 19. Respondent, an experienced CPA, certified management accountant, certified government financial manager, and certified defense financial manager, knew that recognizing revenue – for items that a customer is not even aware of – constitutes a violation of GAAP. OIP ¶ 4.

Respondent – contending this was merely a "technique" – knew that this was purely results-oriented accounting, as reflected by his admission that "the Army C-12 year end numbers needed to be whatever they had to be in order for Division to make $40M EBIT [earnings before income and taxes]." OIP ¶¶ 25-26. Respondent's repeated misrepresentations to L3's corporate office and external auditor, OIP ¶¶ 30-38, enabled his scheme to go undetected until L3 discovered the sham invoices in June 2014 on a shelf in a billing clerk's office. OIP ¶ 39. This egregious conduct is unreasonable to any "prudent official[] in the conduct of [his] own affairs," and therefore more than sufficient to satisfy the reasonableness standard under Section 13(b)(2)(A). And where, as here, the OIP alleges that Respondent knowingly falsified books and records, which enabled ASD to reach a financial target and triggered bonuses, the Court should conclude that the books and records violations are *per se* unreasonable. *See World-Wide Coin*, 567 F. Supp. at 748 ("[M]isrepresentation, concealment, falsification, circumvention, and other deliberate acts resulting in inaccurate financial books and records are unlawful. . . .").

Confusing the reasonableness inquiry for a materiality standard, Respondent measures the quantitative impact of the sham invoices solely as a proportion of L3's total 2013 revenue disclosed to investors. *See* Respondent's Br. at 5. But materiality is *not* an

element of Section 13(b)(2)(A), Section13(b)(5) or Rule 13b2-1. *See, e.g., World-Wide Coin*, 567 F. Supp. at 749-50; *Stanard*, 2009 WL 196023, at *29-30. Indeed, by any quantitative standard other than materiality to investors – i.e., the standard repeatedly rejected by case law – the $17.9 million accounting misconduct was extremely significant. The sham invoices generated by Respondent:

- Inflated ASD's Q-4 2013 EBIT from $3.5 million to $13.8 million;
- Constituted 28% of revenues on the C-12 Contract for Q-4 2013;
- Represented over 100% of C-12's EBIT for both Q-4 2013 and fiscal year 2013;
- Prompted an internal investigation by L3, which resulted in L3 revising its financial statements. OIP ¶¶ 39, 42;
- Triggered significant management bonuses for ASD's management team, including Respondent. OIP ¶ 9; and
- Ultimately led to the firing of Respondent by L3, not something that a company does for a "*de minimis*" mistake. OIP ¶ 4.

The Court should reject Respondent's attempt to import a materiality requirement into the books and records provisions, consider the plethora of allegations in the OIP relating to Respondent's unreasonable conduct, and deny Respondent's motion to dismiss the books and records claims.

III. THE DIVISION HAS ADEQUATELY PLED THAT RESPONDENT KNOWINGLY CIRCUMVENTED L3'S INTERNAL ACCOUNTING CONTROLS

The OIP pleads that as part of his scheme to generate $17.9 in fictitious revenue, Respondent directed that the invoices corresponding to that revenue be withheld from the

U.S. Army in violation of GAAP and L3's internal controls, including a control that required that invoices be distributed to a customer upon generation. OIP ¶¶ 20-25, 39. These allegations are entitled to the presumption of truth, and are sufficient to plead that Respondent knowingly circumvented a system of internal controls under Section 13(b)(5) of the Exchange Act. Respondent's motion should be denied on this basis alone.

In support of his motion to dismiss the internal controls claim, Respondent represents to the Court that none of the internal controls identified by the Division in response to the Court's June 23, 2017 Order require the delivery of invoices.[6] That assertion is demonstrably false. IR 4, which is included among the 61 controls submitted to the Court by Respondent, provides that:

> The Finance Department posts each invoicing transaction upon its preparation **and distribution to the customer** to a separate subsidiary ledger or general ledger account for each type of billing method used by the Financial Reporting Location, which records information about the invoice (for example, the relevant information listed above in Control No. (3)). Alternatively, batch processing of invoices may be utilized.

Hirce Aff., Ex. A, L3-DOJ-SEC-0000478755 (emphasis added). Moreover, although Respondent provided the Court with a list of some of L3's internal controls, he did not inform the Court about the associated narrative that provides guidance to ASD employees regarding how to comply with those controls, including IR 4.[7] Critically, that document

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[6] The Court did not, as Respondent claims, order "the Division to . . . identify[] the specific internal controls it alleges were circumvented." *See* Respondent's Br. at 7-8. Rather, the Court directed the Division to provide a list of the specific internal controls that are "relevant to the alleged violation of Exchange Act Section 13(b)(5)." *See* Order Granting in Part Motion for More Definite Statement, Admin. Proc. Rulings Release No. 4888, *David Pruitt, CPA*, Admin. Proc. File No. 3-17950 (June 23, 2017). The Division fully complied with the Court's order. *See* June 30, 2017 Letter.

[7] To the extent that the Court deems the list of internal controls submitted by Respondent to be "incorporated by reference" in the OIP or Answer (which it should not) and

provides that "once an invoice is deemed good . . . the Billing Clerk will then distribute the invoice to the customer [through] Wide Area Work Flow ("WAWF") . . . Fax [, or] Mail." *See* Baker Decl., Ex. A., L3-DOJ-SEC-0000244783. Respondent is clearly aware of this process narrative, because he emailed it (among other documents) to the ASD leadership team prior to a staff conference in March 2013, the same year of his misconduct. *See* Baker Decl., Ex. A. And the Division referred to this same document in a filing with the Court just last month. *See* Division's Opp. to Respondent's Motion for a More Definite Statement at n.5 (June 13, 2017). Respondent's failure to address this document is illuminating.

Respondent mischaracterizes the OIP by claiming that the Division's internal controls claim is based on Respondent's circumvention of only one control. *See* Respondent Br. at 7-9. But as the Division has made clear on multiple occasions, this claim is based on Respondent's circumvention of "**a system of** internal accounting controls." *See* OIP ¶ 44 (emphasis added); Letter from Paul G. Gizzi to John J. Carney dated June 30, 2017 ("June 30, 2017 Letter") at 1. By way of example, in addition to circumventing IR 4, Respondent knowingly circumvented key control FR 4A (Revenue Recognition Evaluation) by generating invoices and recognizing revenue even though the U.S. Army had not agreed to pay L3 for any of the Revenue Recovery Claims. *See* Hirce Aff., Ex. A, L3-DOJ-SEC-0000478765 ("[C]onditions precedent . . . must be satisfied

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therefore appropriate for consideration on this motion, the Court should also consider the narratives that accompany the list of controls attached to the Baker declaration. *See* *Adrian D. Beamish, CPA*, Admin Proc. Rulings Release No. 4504, 2017 WL 1175585, at *1 (ALJ Jan. 6. 2017) ("[A] motion for a ruling on the pleadings must be based only on the pleadings, matters subject to official notice, matters of public record, and documents attached to, or incorporated by reference in, the OIP or answer.").

[including] proper approval/authorization by the customer. . . ."); June 30, 2017 Letter at 1 (identifying FR4 as relevant to the internal controls claim).

Respondent's directive to generate invoices and recognize $17.9 million in revenue but withhold delivery of the 69 invoices from the U.S. Army constituted a knowing circumvention of L3's internal accounting controls as alleged in the OIP and the June 30, 2017 Letter. The Court should deny Respondent's motion to dismiss the internal controls claim.

CONCLUSION

For the foregoing reasons, the Division respectfully requests that Respondent's motion for a ruling on the pleadings be denied in its entirety.

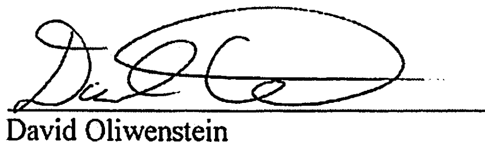
Dated: July 21, 2017
New York, New York

By:

H. Gregory Baker
Paul G. Gizzi
David Oliwenstein
Attorneys for the Division of Enforcement
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281

RULE 154(c) CERTIFICATION

Pursuant to Rule 154(c) of the Commission's Rules of Practice, I hereby certify that this memorandum of law contains 5,285 words, exclusive of the Table of Contents and Table of Authorities.



David Oliwenstein

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17950

In the Matter of,

David Pruitt, CPA,

Respondent.

DECLARATION OF H. GREGORY BAKER, ESQ. IN SUPPORT OF THE DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENT'S MOTION FOR A RULING ON THE PLEADINGS

I, H. Gregory Baker, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am presently employed as Senior Counsel in the Division of Enforcement in the New York Regional Office of the Securities and Exchange Commission. I submit this declaration in support of the Division of Enforcement's Opposition to Respondent's Motion for A Ruling on the Pleadings.

2. Attached hereto as Exhibit A is an email produced by L3 Technologies, Inc. (f/k/a/ L-3 Communications Holdings, Inc.) to the Division of Enforcement, with bates stamp L3-DOJ-SEC-0000244712, and an attachment to the e-mail bates stamped L3-DOJ-SEC-0000244781.

I declare under the penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on July 21, 2017 in New York, NY.

H. Gregory Baker
U.S. Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281
Phone: (212) 336-9147

Exhibit A

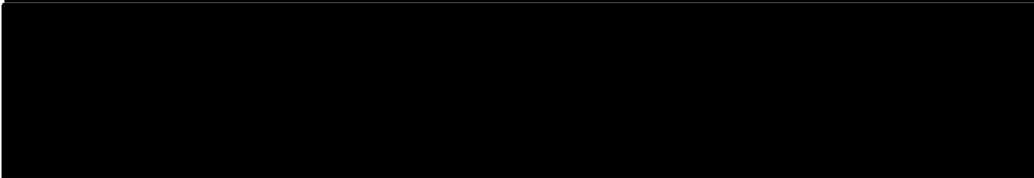
From:	Pruitt, David N. [/O=FRMAINT/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PRUITTD]
Sent:	Saturday, March 30, 2013 10:08:06 PM
To:	Oliver, Tom @ ISG - VERTEX (Tom.Oliver@l-3com.com); McCoy, Marc @ ISG - VERTEX (Marc.McCoy@l-3com.com); Jordan, Steve @ ISG - VERTEX (Steve.Jordan@l-3com.com); Rick Schmidt (Rick.Schmidt2@l-3com.com); Richard Caputo (Richard.Caputo@l-3com.com); Joseph Becker (Joseph.Becker@l-3com.com); Kenneth.Lassus@L-3com.com; Anderson, Thomas A.; Beldner, Aaron @ ISG - SFS (Aaron.Beldner@l-3com.com); Donley, Don; James.Vaughan2@l-3com.com
CC:	Wentlent, Mark
Subject:	ASD Leadership Conference 3-28-13 r3.ppt
Attachments:	ASD Leadership Conference 3-28-13 r3.ppt; SFS Approval Matrix 06142012.xlsx; 2012 ICFR revised Controls.zip; 2012 Narratives.zip

ASD Leadership Conference 3-2...

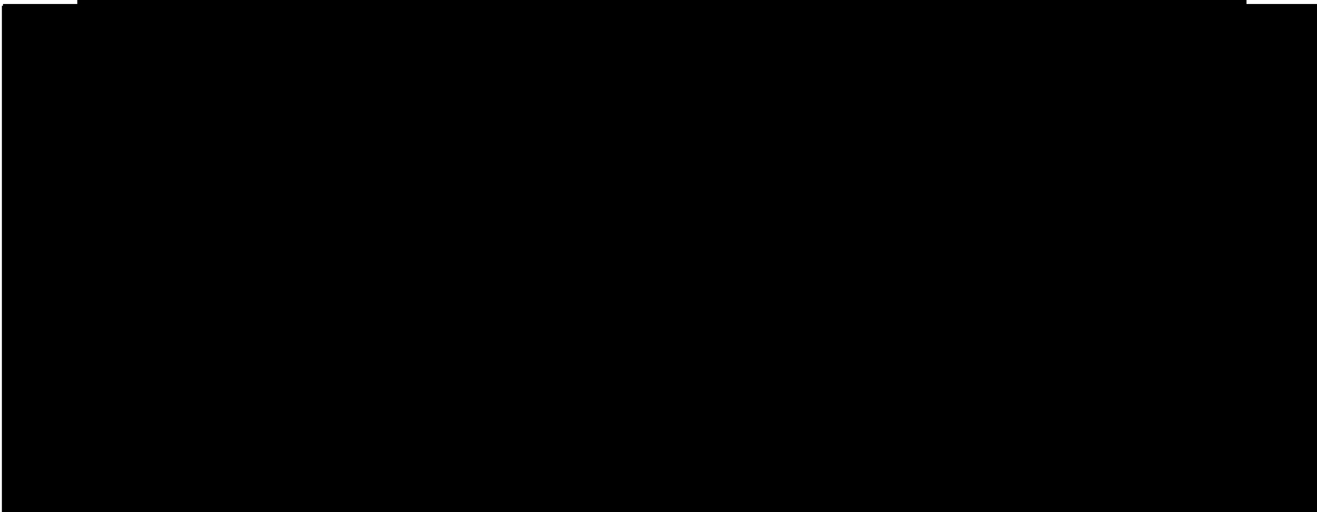
All, attached is the updated ASD Leadership Conference slides that incorporate the Balanced Scorecard work that was done on Friday. I have also attached a copy of the current Approval Matrix (expect revisions soon), the SOX Controls and associated narratives as we discussed.

VR, Dave

FOIA CONFIDENTIAL TREATMENT
REQUESTED BY L-3 COMMUNICATIONS, INC.



FOIA CONFIDENTIAL TREATMENT
REQUESTED BY L-3 COMMUNICATIONS, INC.



The Billing Clerk reviews the printed invoice. If there are any errors, then the corrections