

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 79772 / January 11, 2017**

**ACCOUNTING AND AUDIT ENFORCEMENT**  
**Release No. 3844 / January 11, 2017**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17769**

**In the Matter of**

**L3 Technologies, Inc.**

**Respondent.**

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

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against L3 Technologies, Inc. (“L3” or “Respondent”) (formerly known as “L-3 Communications Holdings, Inc.”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-And-Desist Proceedings Pursuant to Section 21C of the Exchange Act, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### **SUMMARY**

1. These proceedings arise out of L3's failure to maintain books, records and accounts that accurately reflected the transaction and dispositions of its assets, and for failing to maintain a sufficient system of internal accounting controls. These failures relate to L3's Army Sustainment Division ("ASD") improperly recording \$17.9 million in revenue at the time based on invoices associated with unresolved claims against the U.S. Army that were created in L3's internal accounting system but not delivered to the customer.

2. Employees aware of creating these invoices immediately reported concerns regarding potential violations of L3's accounting policies and internal accounting controls to L3's internal ethics department, which undertook a prompt review. But the review was not conducted in a sufficient and effective manner due in part to a failure by ethics investigators to adequately understand the billing process involved and their misinterpretation of statements made by witnesses.

3. As a consequence, it was not until June 2014 that L3 discovered the invoices that ASD had created in connection with unresolved claims but that had not been delivered. Based on a subsequent internal investigation, L3 concluded it had material weaknesses in its Internal Control Over Financial Reporting ("ICFR") for the fiscal year ended December 31, 2013 and the end of the fiscal quarter ended March 28, 2014, and the company revised its financial statements from 2011 through 2014.

#### **RESPONDENT**

4. L3, a Delaware corporation based in New York, New York, 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, and its securities trade on the New York Stock Exchange under the symbol LLL.

#### **FACTS**

##### **The C-12 Contract**

5. L3 contracted to maintain, through its subsidiary Vertex and later ASD, a fleet of approximately 100 fixed-wing C-12 airplanes for the U.S. Army at bases in the United States and around the world pursuant to a contract referred to as the "C-12 Contract." The C-12 Contract had an approximately five-year term, commencing on June 2, 2010, and ending on January 31, 2015. In 2013, executives at ASD, the L3 division that managed the contract, realized that it had low margins, and in mid-2013, they realized that the contract was projected to lose money for the fiscal

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<sup>1</sup> 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.

year, putting ASD at risk of not making its annual operating plan. The executives also determined that work had been performed on the C-12 Contract that was not billed to the U.S. Army.

### **The Revenue Recovery Initiative**

6. In or around August 2013, executives at ASD developed a “Revenue Recovery Initiative,” which had the purpose of identifying work performed under the C-12 Contract but that had not been billed to the U.S. Army, and then developing a plan to bill the U.S. Army for that work. By November 2013, ASD determined that approximately \$50 million in work had been performed on the C-12 Contract but not billed.

7. Because of the complicated nature of the services performed under the contract, and the need for the U.S. Army to verify the work performed, L3 and the U.S. Army did not reach an agreement on payment of the unbilled items by the end of 2013.

### **Creation of Invoices**

8. Facing pressure from certain supervisors, in December 2013, the VP of Finance at ASD requested that certain ASD employees generate approximately 69 invoices on performed but unbilled work related to the C-12 Contract, but refrain from delivering them to the U.S. Army. ASD recognized an additional \$17.9 million in revenue at the time based on the undelivered invoices, enabling ASD to barely satisfy the target required in order to qualify for management incentive bonuses.

9. L3’s revenue recognition policy, consistent with Generally Accepted Accounting Principles (“GAAP”), set forth four requirements that must generally be met before revenue can be realized and earned: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller’s price to the buyer is fixed or determinable; and (4) collectability is reasonably assured.

10. As of the end of 2013, collectability was not reasonably assured with respect to the invoices because the invoices corresponded to claims L3 was asserting or intended to assert against the U.S. Army but which the customer had not reviewed or agreed to resolve.

11. ASD’s financial statements roll up into L3’s consolidated financial statements, causing L3 to improperly recognize revenue related to the C-12 Contract.

### **Reports to Ethics**

12. While deliberate steps were taken by an individual to evade L3’s internal accounting controls and to mislead L3’s external auditors, L3’s internal accounting controls failed to detect and prevent the improper recognition of revenue on the C-12 Contract. In November 2013, an employee at L3 filed an ethics report concerning certain aspects of the C-12 Contract. In response to the report, L3’s internal ethics department commenced an investigation of the allegations.

13. In December 2013, when the 69 invoices on unbilled work related to the C-12 Contract were created, an additional specific report was raised to L3's internal ethics department, which promptly conducted several interviews to investigate the report.

14. However, the ethics investigators failed to identify the improper revenue recognition issue because they did not adequately understand the billing process for the C-12 Contract, and misinterpreted statements made to them by witnesses. As a consequence, the invoice issue was not timely raised to the Audit Committee of L3's Board of Directors.

### **L3's Internal Investigation and Disclosures**

15. In June 2014, when L3 discovered the invoices that had been generated in December 2013 but not delivered to the U.S. Army, L3 conducted an internal investigation using outside advisors, which determined that ASD improperly recognized revenue on invoices that were generated but never delivered to the customer, in violation of L3's revenue recognition policy and GAAP.

16. On July 31, 2014, L3 issued a press release reporting its preliminary unaudited financial results for the second quarter of 2014, which explained that the company was conducting an internal review of accounting matters at its Aerospace Systems segment. The press release noted that L3 expected to incur a pre-tax charge against operating income and a related reduction in net sales for periods prior to 2014 and the first half of 2014, primarily as a result of certain contract cost overruns that were inappropriately deferred and overstatements of net sales, both of which were related to a fixed price maintenance and logistics support government contract referred to as the "C-12 Contract."

17. 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. The amendments disclosed that, following the internal review of the Aerospace Systems segment, L3 identified material weaknesses in the company's ICFR, and that, as a result, the company's ICFR and disclosure controls and procedures were not effective as of the end of the fiscal year ended December 31, 2013, or the end of the fiscal quarter ended March 28, 2014. The 2013 10-K/A and 1Q:14 10-Q/A specifically reported that:

(1) the Company did not maintain an effective control environment at its Aerospace Systems segment with respect to: (i) inadequate execution of existing controls around the annual review and approval of contract (revenue arrangement) estimates; (ii) not following established Company accounting policies, controls and procedures, and (iii) intentional override of numerous transactional and monitoring internal controls at our Army Sustainment division; and (2) Company personnel did not perform reviews of certain employee concerns regarding violations of our accounting policies and ICFR in a sufficient and effective manner. [2013 10-K/A at 35; 1Q:14 10-Q/A at 39.]

18. The amended filings further disclosed that with respect to its Aerospace Systems group, L3 identified and recorded pre-tax charges of \$60 million for 2013; \$25 million for 2012;

\$5 million for 2011; \$4 million for periods prior to 2011; \$20 million for 1Q:14; and \$55 million for 2Q:14, for a total of \$169 million in the group. The adjustments identified in Aerospace Systems group related to the Logistics Solutions and Platform Solutions sectors, with aggregate adjustments of \$117 million for Logistics Solutions, and \$52 million for the Platform Systems.

19. Of the \$117 Logistics Solutions adjustments, \$69 million were attributable to the C-12 Contract due to “cost overruns inappropriately deferred, sales invoices inappropriately prepared, and the failure to timely and accurately perform contract estimates at completion and valuation assessments of inventories and receivables” at the Army Sustainment Division of Logistics Solutions, as well as \$48 million attributable to “accounting errors . . . in connection with the valuation inventories and receivables, as well as the correction for certain accruals on other logistics support contracts” [2013 10-K/A at 35; 1Q:14 10-Q/A at 40.]

20. The \$52 million Platform Systems sector adjustments were related to losses of \$37 million on two aircraft modification contracts and two contracts for rotary wing sub-assemblies and parts, and write-offs of deferred costs of \$15 million to design and test aerostructures for a new commercial aircraft.

21. The amended filings further disclosed that, unrelated to the review at the Aerospace Systems segment, L3 evaluated the accounting treatment related to a sales-type lease transaction with the U.S. Army for rotary wing flight simulator systems. Based on the results of this evaluation, L3 revised its previously issued financial statements to increase interest income accretion for the first six months of 2014, 2013, 2012, and periods prior to 2011 by an aggregate amount of \$25 million, and an aggregate decrease in sales by \$15 million for 2013 and the first six months of 2014, and aggregate decrease in the cost of sales of \$19 million for the first six months of 2014, 2013 and periods prior to 2011.

22. The amended filings further disclosed that L3 revised its previously issued financial statements to correct for certain errors recorded in the company’s financial statements in order to reflect them in the appropriate periods.

23. Approximately \$69 million of the pre-tax adjustments related to the C-12 Contract, and of that amount, approximately \$15.4 million in pre-tax income was the result of misconduct by certain executives in ASD in connection with the invoices.

### **VIOLATIONS**

24. By virtue of the conduct described above, L3’s books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

25. Also by virtue of the conduct described above, L3 failed to implement internal accounting controls sufficient to provide reasonable assurances that its accounts were accurately stated in accordance with generally accepted accounting principles.

26. As a result of the conduct described above, L3 violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts

which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

27. Also as a result of the conduct described above, L3 violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

### **L3's REMEDIAL ACTS AND COOPERATION**

28. In its 10-K issued for fiscal year 2015, L3 disclosed that it had undertaken certain steps to remediate its material weaknesses in its ICFR, and that it had tested these controls and determined them to be effective. In determining to accept the Offer, the Commission considered extensive remedial acts promptly undertaken by Respondent, including conducting an internal investigation, terminating a number of employees associated with the conduct in question, and self-reporting the matter to the Commission; and the cooperation afforded the Commission staff.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent L3's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent L3 cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. L3 shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$1.6 million 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 L3 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.

C. 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, it shall not argue that it is entitled to, nor shall it 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 it 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.

D. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of \$1.6 million based upon its cooperation in a Commission investigation and/or related enforcement action. If at any time following the entry of the Order, the Division of Enforcement obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission, or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil monetary penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields  
Secretary