Press Release

SEC Charges Government Contractor With Inadequate Controls and Books and Records Violations

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Washington D.C., Jan. 11, 2017 — The Securities and Exchange Commission today announced that L3 Technologies Inc. (formerly known as L-3 Communications Holdings Inc.), a contractor for U.S. and various foreign government agencies, has agreed to pay a $1.6 million penalty to settle charges that it failed to maintain accurate books and records and had inadequate internal accounting controls.

An SEC investigation found that in December 2013, L3’s Army Sustainment Division (ASD) – part of L3’s Aerospace Systems segment – improperly recorded $17.9 million in revenue from a contract with the U.S. Army by creating invoices associated with unresolved claims against the U.S. Army that were not delivered when the revenue was recorded. While certain employees immediately reported their concerns to L3’s ethics department, the subsequent ethics review failed to uncover the misconduct due, in part, to a failure by internal investigators to adequately understand the billing process. In October 2014, following a subsequent investigation conducted by outside advisors, L3 concluded it had material weaknesses in its internal controls over financial reporting for the fiscal year ended Dec. 31, 2013 and for the first quarter of 2014. L3 revised its financial statements from 2011 to 2014.

“Adequate internal accounting controls function as a critical safeguard against the type of improper revenue recognition that occurred at L3,” said Andrew M. Calamari, Director of the SEC’s New York Regional Office. “L3 failed to have such controls in place, which rendered inaccurate its books and records.”

According to the SEC’s order, in or around August 2013, ASD executives developed a “Revenue Recovery Initiative” that identified approximately $50 million in work performed under a contract with the U.S. Army that had not been billed. Because L3 and the U.S. Army had not reached any agreement on payment for the work performed, any revenue recognition for that work would have been improper under relevant accounting rules. Nonetheless, in December 2013, a senior finance official at ASD requested that 69 invoices be generated – but not delivered – to the U.S. Army, which caused ASD to recognize almost $18 million in revenue. Because of that revenue, ASD employees barely satisfied an internal target for management incentive bonuses.

The SEC’s order finds that immediately after the 69 invoices were generated, ASD employees internally reported to L3’s ethics department, but a subsequent internal investigation concluded that there was no improper revenue recognition and the issue was not promptly raised to the L3’s Audit Committee. In June 2014, L3 retained outside advisors to conduct an internal investigation, which concluded that the revenue recognized on the undelivered invoices was improper. This investigation uncovered additional accounting errors in L3’s Aerospace Systems segment from 2011 to 2014, which combined with the improper accounting associated with the 69 undelivered invoices had the effect of overstating the company’s pre-tax income by $169 million.
Without admitting or denying the findings, L3 agreed to pay the $1.6 million penalty and consented to the entry of the SEC’s cease-and-desist order finding that it violated the books and records and internal controls provisions of the federal securities laws.

The SEC’s continuing investigation is being conducted by H. Gregory Baker, David Oliwenstein, Christopher Mele, and Steven G. Rawlings of the New York Office, and the case is being supervised by Sanjay Wadhwa.

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**Related Materials**

- SEC order