

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
RELEASE NO. 56105 / July 19, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
RELEASE NO. 2648 / July 19, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12704

In the Matter of	:	ORDER INSTITUTING CEASE-AND-
	:	DESIST AND PUBLIC ADMINISTRATIVE
DAVID C. DRUMMOND,	:	PROCEEDINGS PURSUANT TO SECTION 21C
JOHN P. HAYES, FCA, and	:	OF THE SECURITIES EXCHANGE ACT
PATRICK E. MURPHY, FCA,	:	OF 1934 AND RULE 102(e) OF THE
	:	COMMISSION'S RULES OF PRACTICE
Respondents.	:	MAKING FINDINGS, IMPOSING A
	:	CEASE -AND-DESIST ORDER, REMEDIAL
	:	SANCTIONS, AND OTHER RELIEF

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against David C. Drummond ("Drummond"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and that cease-and-desist and public administrative proceedings be, and hereby are, instituted against John P. Hayes ("Hayes") and Patrick E. Murphy ("Murphy") pursuant to Section 21C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)].¹

II.

¹ Rule 102(e)(1)(iii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement (“Offers”) that 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 them and over the subject matter of these proceedings, which are admitted, the Respondents each consent to the entry of this Order Instituting Cease-And-Desist and Public Administrative Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, Imposing a Cease-And-Desist Order, Remedial Sanctions, and Other Relief (“Order”), as set forth below.

III.

On the basis of this Order and the Respondents’ Offers, the Commission finds² that:

A. **RESPONDENTS**

1. Drummond, age 43, is a resident of San Jose, California. Drummond was the Chief Financial Officer (“CFO”) of SmartForce PLC (“SmartForce” or the “Company”), now known as SkillSoft PLC (“SkillSoft”), from July 1999 to February 2002, when he left the Company to become General Counsel and Vice President (“VP”) for Corporate Development of another now public company. Prior to joining SmartForce as the CFO, Drummond was a partner at a major law firm and his professional training is as a lawyer. Drummond has no formal training in accounting and has never been a certified public accountant.

2. Murphy, age 56, is an Irish citizen. Murphy is a chartered accountant and has been a member of the Institute of Chartered Accountants (“ICA”) in Ireland since 1989, which is similar to being a certified public accountant in the United States.³ Murphy joined SmartForce in January 1996 as a group controller and reported to Hayes. As a group controller, Murphy worked primarily on consolidation of the North America and Australia accounts. Murphy was promoted to VP of Finance-North America in January 1998 and then to VP of Global Finance in September 2001. In February 2002, Murphy became the acting CFO, a

² The findings herein are made pursuant to Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

³ Members of the ICA use the designatory letters ACA for associate chartered accountant and FCA for fellow chartered accountant.

position he held until the merger. Prior to joining SmartForce, Murphy worked for Ernst & Young Chartered Accountants in Dublin (“EYCA”) where he performed work on the account of CBT Systems Limited (predecessor to SmartForce) at the company’s California headquarters during 1995.

3. Hayes, age 53, is an Irish citizen. Hayes is a chartered accountant and has been a member of the ICA in Ireland since 1983. In 1986, Hayes joined SmartForce (then CBT Systems Limited, which at the time was privately-held) as the controller. Around the time that CBT Systems went public in 1995, Hayes became the chief accounting officer and was responsible for making all accounting decisions at the company. After Murphy joined the Company, he and Hayes divided the accounting responsibilities: Murphy became responsible for the accounts in the Americas and Australia while Hayes remained responsible for the European and South African accounts. Hayes retained the title of VP of Finance for the European Division from January 1998 until September 2001, when he retired from the Company.

B. RELATED PARTY

SkillSoft is a public limited company organized under the laws of the Republic of Ireland. SkillSoft maintains its principal executive offices in New Hampshire. SkillSoft is the product of a September 6, 2002 merger between the SkillSoft Corporation (“SkillSoft Corp.”) and SmartForce, a company organized under the laws of the Republic of Ireland that began trading on NASDAQ in April 1995. Although SmartForce emerged as the surviving entity, SkillSoft Corp. was deemed to be the acquirer for accounting purposes. Following the merger, SmartForce changed its name to SkillSoft PLC. In this order “SmartForce” refers to SmartForce PLC prior to the merger with SkillSoft Corp. SkillSoft provides an Internet-based management and technology platform for training courseware, seminars, and reference materials geared toward business and IT professionals. SkillSoft’s securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on NASDAQ.

C. FACTS

1. The Merger Between SmartForce and SkillSoft

On June 10, 2002, SkillSoft Corp. and SmartForce issued a press release announcing that the two companies had signed a definitive agreement to merge in a stock-for-stock transaction. A couple of weeks later, SmartForce filed a registration statement on Form S-4, regarding the merger, in which SmartForce’s financial statements, including an unqualified audit report by EYCA dated January 16, 2002, were incorporated by reference.

2. The Restatement

Before the markets opened on November 19, 2002, SkillSoft announced that in the process of preparing SmartForce’s closing balance sheet, SkillSoft identified several accounting

issues concerning generally accepted accounting principles in the United States (“GAAP”) that would require SkillSoft to restate SmartForce’s historical financial statements for the three-year period ended December 31, 2001 and for the six months ended June 30, 2002 (the “Restatement Period”). Although the precise amount of the restatement was unknown at the time, SkillSoft estimated that SmartForce had prematurely recognized approximately \$35 million to \$40 million in revenue. SkillSoft also announced, along with the accounting restatement, that SkillSoft would be exiting three service lines of business with an approximately \$30 million annual reduction in revenue, and that SkillSoft had been experiencing materially lower renewal rates. The day after the announcement, SkillSoft’s stock price fell from \$4.63 per share to \$3.07 per share, a drop of 33.7 percent.

On September 22, 2003, SkillSoft filed with the Commission a Form 8-K/A, restating SmartForce’s historical financial statements for the three-year period ended December 31, 2001 and for the six months ended June 30, 2002. Due to the nature and severity of the accounting issues identified, Ernst & Young LLP in the United States, SkillSoft’s auditors, re-audited the financial statements pertaining to the entire Restatement Period and made over 300 adjustments to correct the previously issued financial statements. In the restatement, SkillSoft corrected multiple inaccurate accounting entries - primarily misapplication of certain revenue recognition principles by SmartForce, which had resulted in an overstatement of revenue by \$113.6 million and net income by approximately \$127 million during the Restatement Period.

3. Accounting for Software Sales

GAAP requires that revenue from the sale or license of software be recognized consistent with AICPA Statement of Position 97-2, as amended, (“SOP 97-2”). SOP 97-2 specifies the circumstances in which a company may recognize software license revenue upon delivery, and when a company must defer revenue recognition. Software license revenue is generally recognizable upon delivery under SOP 97-2 if no significant production, customization or modification of software is required, if the remaining undelivered elements of the parties' arrangement are not essential to the functionality of the software, and if the following four basic criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred; (iii) the vendor's fee is fixed or determinable; and (iv) collectibility is probable. Paragraph 28 of SOP 97-2 provides, among other things, that “if payment of a significant portion of the software licensing fee is not due until after the expiration of the license or more than twelve months after delivery, the licensing fee should be presumed not to be fixed or determinable.” Moreover, when an arrangement involves multiple elements (e.g., software, upgrades, or consulting services), Paragraph 10 of SOP 97-2 requires that the fee be:

allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated within the contract for each element. Vendor-specific objective evidence of fair value is limited to the following:

- The price charged when the same element is sold separately;

- For an element not yet being sold separately, the price established by management having the relevant authority; it must be probable that the price, once established, will not change before the separate introduction of the element into the marketplace.

SOP 97-2 makes clear that the price for an element as included in a price list does not necessarily represent vendor-specific objective evidence of fair value (“VSOE”) for that element.

4. Accounting for Non-Monetary Transactions

Under GAAP, accounting for non-monetary transactions should be based on the fair value of the assets or services involved, if it can be determined within reasonable limits. See Accounting Principles Board Opinion No. 29, “Accounting for Nonmonetary Transactions” (“APB 29”). Paragraph 25 of APB 29 states, among other things, that fair value of an asset “should be determined by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence.” If neither the fair value of a non-monetary asset transferred nor the fair value of a non-monetary asset received in exchange is determinable within reasonable limits, the recorded amount of the non-monetary asset transferred from the enterprise may be the only available measure of the transaction. APB 29, para. 26.

5. Accounting Practices by SmartForce

During the Restatement Period, SmartForce engaged in various improper accounting practices, including premature recognition of revenue from multi-element arrangements, improper recognition of revenue from reciprocal transactions, and premature recognition of revenue from reseller agreements. As a result of these accounting practices, SmartForce overstated its revenue by \$113.6 million and net income by approximately \$127 million.

The vast majority of the overstated revenue related to misapplication of the accounting guidance regarding VSOE and extended payment terms. More specifically, SmartForce recognized revenue upon delivery from multi-element arrangements despite not having VSOE for each undelivered element as required under GAAP. Similarly, SmartForce recognized revenue upon delivery from sales agreements that contained payment terms extending beyond 12 months even though the Company had no history of collecting on similar agreements without making concessions.

In addition, during 2001, SmartForce also entered into several reciprocal non-monetary transactions with its customers, whereby the Company both sold and purchased goods or services without sufficient evidence to support the fair value of the goods or services exchanged. SmartForce recognized license revenue upon delivery of the software sold to its

customers and recorded the purchases from its customers as if they had been separate, unrelated transactions. Instead, SmartForce should have recorded the sales and purchases as exchanges pursuant to APB 29, such that there would have been a gain only to the extent of any net cash received. Most of the reciprocal deals also included multiple elements and had extended payment terms. Revenue recognition from these transactions was also improper because the Company failed to meet the requirements under provisions of SOP 97-2 pertaining to VSOE and extended payment terms.

SmartForce also recognized revenue prematurely from reseller transactions, some of which were non-binding agreements and some of which contained termination clauses that allowed the customer to terminate the agreement prior to its expiration. For example, during the second and fourth quarters of 2001, SmartForce improperly recognized \$5.5 million of revenue from two non-binding agreements with a reseller.

Consequently, SmartForce's financial statements, which were included in the Company's annual and quarterly reports during the Restatement Period, were materially false and misleading in that they overstated net income and revenue by failing to comply with GAAP. Several registration statements incorporated by reference various SmartForce financial statements for the restated periods. This Order relates only to the financial statements of SmartForce for the restated periods prior to the merger between SmartForce and SkillSoft Corp.

6. The Conduct of Respondents Murphy and Hayes

Murphy and Hayes shared the primary responsibility for the accounting decisions at SmartForce and for making sure that such accounting complied with GAAP. Murphy was responsible for the accounts from the Americas and Australia, which constituted 70 percent of SmartForce's business, while Hayes was responsible for the European and South African accounts, which represented the other 30 percent of SmartForce's business.

On several multi-element arrangements, Murphy and Hayes improperly concluded that SmartForce had VSOE for each element of the arrangement and determined that the Company could recognize revenue up-front for the delivered elements. SmartForce, however, did not have VSOE for each element of its multi-element arrangements because (i) the elements were not sold separately, and (ii) the list price was not representative of fair value, as the Company offered its customers significant discounts from the list price. The discount percentage varied from customer to customer. However, SmartForce performed no analysis to determine which elements were sold separately and whether there was an adequate amount of separate sales to support the fair value of the elements, nor did it perform an analysis to assess how the discounts affected its price list. Accordingly, the determination that SmartForce had VSOE for each element of the multi-element arrangements did not conform with GAAP.

Moreover, despite the extended payment terms in the arrangements, Murphy and Hayes incorrectly concluded that the fees being charged by SmartForce were fixed or determinable. In

doing so, Murphy and Hayes concluded that the Company had a history of entering into such agreements and had successfully collected on them without granting concessions. SmartForce, however, did not have an adequate history of successful payment collections without concessions.

During 2001, SmartForce engaged in several reciprocal non-monetary arrangements with certain customers. In these arrangements SmartForce simultaneously sold and purchased products or services from the same customer, or the Company and the customer agreed to sell each other's products. Murphy and Hayes allowed SmartForce to recognize the total amount from such sales as revenue. The Company, however, should have recorded a gain only to the extent of any net cash received.

For example, in mid-June 2001, SmartForce and a customer executed a three-year multi-element arrangement. The arrangement entitled the customer to use (i) SmartForce's platform and generic courseware, and (ii) third party content. The third party content consisted of software developed by a private software company.

The total price SmartForce charged the customer for the arrangement was \$5 million, of which \$800,000 was applied toward the license for the SmartForce platform and generic courseware, while the remaining \$4.2 million was earmarked for the software company's content. The agreement obligated the customer to make two payments of \$2.5 million to SmartForce, on July 6, 2001 and October 5, 2001. Even though SmartForce did not determine fair value for either the courses it was selling to the customer or the software it was purchasing from the private software company, at Murphy's direction, the Company recorded \$4.3 million as revenue from this arrangement. Such accounting did not comport with GAAP.

During the relevant period, Murphy and Hayes sold shares of SmartForce at prices that were inflated because of the accounting issues.

7. Respondent Drummond's Conduct

Drummond was hired as CFO of SmartForce in July 1999. Drummond is a lawyer who had been a partner at a major law firm and who had no formal accounting training or background. Accordingly, the accounting function was handled primarily by Hayes and Murphy although Drummond, in his capacity as CFO, ultimately had responsibility for SmartForce's financial statements.

During late June 2001, SmartForce entered into a letter agreement with a reseller whereby the reseller agreed to "endeavor" to sell \$2 million of SmartForce courseware. More specifically, the letter agreement provided that the reseller would endeavor to bundle a minimum of 400,000 units of SmartForce training courses with other software, and would pay SmartForce \$5.00 per each bundle shipped. Drummond learned of this non-binding agreement before the end of the second quarter 2001, and knew or should have known that it would have been improper for SmartForce to recognize revenue from such agreement. Nonetheless,

Drummond did not take any steps to determine whether SmartForce was recognizing revenue from the agreement or whether the accounting for the agreement complied with GAAP. SmartForce incorrectly recognized the \$2 million as revenue and included the revenue in its Form 10-Q for the second quarter of 2001.

Moreover, prior to the end of the second quarter 2001, Drummond became aware of the arrangement among SmartForce, the private software company, and the customer described above, as he was consulted by the SmartForce salespeople negotiating the arrangement with the customer and actively participated in negotiating the transaction. Drummond knew that the customer dictated the price that SmartForce paid for the third party content described above. Because Drummond relied on Murphy to account for this three-way arrangement, Drummond should have communicated such information to Murphy. Drummond, however, failed to do so. Furthermore, Drummond did not take any steps to determine whether the accounting for the arrangement complied with GAAP. Consequently, for fiscal 2001, SmartForce recognized \$4.3 million on this arrangement and included that revenue in the Company's Form 10-K for the year ended December 31, 2001.

During the relevant period, Drummond sold shares of SmartForce at prices that were inflated because of the accounting issues.

8. Federal Securities Laws Violations and Findings

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Exchange Act Rule 12b-20 further requires the inclusion of any additional material information that is necessary to make required statements, in light of the circumstances under which they were made, not misleading. Information regarding the financial condition of a company is presumptively material. *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(b)(2)(A) of the Exchange Act.

Section 13(b)(2)(B) of the Exchange Act requires Section 12 registrants to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific

authorization; (ii) transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (ii) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences." Section 13(b)(5) of the Exchange Act provides that "no person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account" described in Section 13(b)(2)(B). As a result of the conduct described above, Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Section 13(b)(2)(B) of the Exchange Act. Moreover, as a result of the conduct described above, Drummond violated, and Murphy and Hayes willfully violated, Section 13(b)(5) of the Exchange Act.

Based on the foregoing, the Commission finds that (a) Drummond caused, and Murphy and Hayes willfully aided and abetted and caused, SkillSoft's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 promulgated thereunder; and (b) Drummond violated, and Murphy and Hayes willfully violated, Section 13(b)(5) of the Exchange Act.

Based on the foregoing, the Commission finds that Murphy and Hayes willfully violated and willfully aided and abetted violations of the federal securities laws and rules thereunder within the meaning of Rule 102(e)(1)(iii) of the Commission's Rules of Practice and as accountants are subject to sanctions under the Rule.

D. UNDERTAKINGS BY RESPONDENTS

1. Respondents each undertake and agree to cooperate fully with the Commission in any and all Commission investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondents have undertaken:

- a. To produce, without service of a notice or subpoena, any and all relevant and non-privileged documents and other information requested by the Commission's staff;
- b. If requested by the Commission's staff, Respondents Drummond, Murphy, and Hayes shall agree to be interviewed by the Commission's staff at such times as the staff reasonably may direct, and appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials;

2. In determining to accept the Respondents' Offers of Settlement, the Commission has considered the undertakings set forth in this Section.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondents Drummond, Murphy, and Hayes shall cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act; and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

B. Respondents Murphy and Hayes are denied the privilege of appearing or practicing before the Commission as accountants.

C. After two (2) years from the date of this order Murphy may request that the Commission consider his reinstatement. After two (2) years from the date of this order Hayes may request that the Commission consider his reinstatement. Each Respondent shall make any such request by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that the Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board or equivalent Irish organization and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board or

equivalent Irish organization, and has complied with all terms and conditions of any sanctions imposed (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as the Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by either Respondent to resume appearing or practicing before the Commission provided that his chartered accountant license is current and he has resolved all other regulatory or disciplinary issues, if any, with the applicable Irish institute of chartered accountants. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent Drummond shall, within 10 days of the entry of this Order, pay disgorgement of \$454,105 and prejudgment interest of \$119,874 to the United States Treasury.

F. Respondent Murphy shall, within 10 days of the entry of this Order, pay disgorgement of \$449,269 and prejudgment interest of \$118,597 to the United States Treasury.

G. Respondent Hayes shall, within 10 days of the entry of this Order, pay disgorgement of \$673,882 and prejudgment interest of \$188,513 to the United States Treasury.

H. Such payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies the particular Respondent in these proceedings, the file number of these proceedings, a copy of

which cover letter and money order or check shall be sent to Carlos Costa-Rodrigues, Boston District Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

By the Commission.

Nancy M. Morris
Secretary