

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53404 / March 3, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2392 / March 3, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12227

<p>In the Matter of</p> <p>ANDREW J. McADAMS, CPA,</p> <p>Respondent.</p>	<p>ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION’S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS</p>
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I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against Andrew J. McAdams, CPA (“Respondent” or “McAdams”) pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.¹

II.

¹ Rule 102(e)(1)(ii) 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 engaged in unethical or improper professional conduct.

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 him and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions (“Order”) as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds² that:

A. SUMMARY

Aerosonic Corporation (“Aerosonic” or “the Company”), an airplane parts manufacturer located in Clearwater, Florida, recorded fictitious revenue at the direction of its former Chief Executive Officer (“CEO”) and former Chief Financial Officer (“CFO”) through a number of accounting schemes, including creating fraudulent inventory entries and improper revenue recognition, in violation of Generally Accepted Accounting Principles (“GAAP”). As audit engagement partner on the Aerosonic audits for PricewaterhouseCoopers LLP (“PwC”), McAdams supervised the audit services PwC performed for Aerosonic. PwC issued audit reports containing unqualified opinions on Aerosonic’s fiscal year 1999 through 2002 financial statements, signed by McAdams. In supervising those audit services, however, McAdams failed to perform his work in accordance with Generally Accepted Auditing Standards (“GAAS”) for the audits of Aerosonic’s financial statements for its fiscal years ended 1999 through 2002. With regard to some significant audit items in those years, he did not adequately plan and supervise the audits, did not obtain sufficient competent evidential matter, did not maintain an attitude of professional skepticism, and placed undue reliance upon former senior management’s representations. McAdams thereby engaged in improper professional conduct in connection with PwC’s audits of Aerosonic’s financial statements within the meaning of SEC Rule 102(e).

B. RESPONDENT

McAdams, 52, of Palm Harbor, Florida has been a PwC (or Coopers & Lybrand LLP, one of PwC’s predecessor firms) partner since 1985, and was the managing partner of PwC’s Tampa and Orlando offices from 2001 until February 2005. From fiscal year 1996 to fiscal year 2002, McAdams was the engagement partner for the audits of

² 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.

Aerosonic's year-end financial statements by PwC and Coopers & Lybrand LLP. In February 2005, McAdams became a business development partner for PwC. McAdams is a certified public accountant licensed in the State of Florida.

C. OTHER RELEVANT ENTITIES

1. **Aerosonic** is a Delaware corporation headquartered in Clearwater, Florida. Aerosonic is an airplane instruments manufacturer whose common stock is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"). Aerosonic's fiscal year ends on January 31st (i.e. fiscal year 2003 begins February 1, 2002 and ends January 31, 2003).

2. **PwC** is an accounting firm, headquartered in New York, New York. PwC audited Aerosonic's financial statements for the fiscal years ended 1999 through 2002 ("the relevant time period"), that were included by Aerosonic in its filings with the Commission on Form 10-K. PwC also performed review procedures on Aerosonic's quarterly reports on Form 10-Q.

D. FACTS

1. Aerosonic's False Financial Statements

Aerosonic's primary business as an airplane instruments manufacturer made inventory one of its most important assets. From fiscal year 1999 through 2002, inventory was Aerosonic's largest and fastest growing balance sheet item, at its height totaling \$10.9 million at year-end, and representing between 40% to 50% of total assets. Inventory growth became particularly critical to Aerosonic beginning in 1999; specifically, inventory levels needed to be sustained at high levels to keep the cash-strapped company from defaulting on millions of dollars worth of loans secured by the Company's inventory. Aerosonic's CEO, through his autocratic management style and tight control of the Company's finances, was determined to ensure that Aerosonic recorded inventory values necessary to support its growth and outstanding debt.

Beginning in 1999, Aerosonic's CEO and CFO began managing earnings by causing Aerosonic to record fictitious revenue, or avoid significant inventory write-offs, through a number of revenue recognition and inventory schemes. These accounting manipulations included: (a) overstating inventory by falsifying inventory records; (b) failing to value inventory at lower of cost or market; (c) improperly capitalizing labor and overhead costs into inventory; (d) failing to provide adequate reserves for obsolete and slow moving inventory; and (e) inflating earnings by recording fictitious and premature revenues. The fraudulent accounting had a material impact on Aerosonic's financial statements for the relevant time period, inflating Aerosonic's income before taxes reported in its Form 10-Q and Form 10-K filings with the Commission from fiscal year 1999 through the first three quarters of fiscal year 2003.

On March 17, 2003, Aerosonic's new management disclosed that Aerosonic had materially misstated financial results for its fiscal years 1999 through 2002, and for its first three quarters of 2003. In October 2003, Aerosonic restated over \$8.6 million in revenue and inventory-related items for its fiscal years ended 1999 through 2002, and for its first three fiscal quarters of 2003.

McAdams was aware, at least since 1999, that Aerosonic's CEO dominated the Company's board of directors, management, and financial reporting, and that Aerosonic's inventory carried an inherent risk of material misstatement and was significant to the balance sheet. Since 2000, the PwC audit teams headed by McAdams also had identified indications of significant weaknesses in Aerosonic's financial accounting process, such as in one year, "[an] accounting staff that was inadequate in light of the complexity and size of the business." Yet without sufficient audit inquiry, McAdams caused PwC to render an unqualified audit report on the financial statements included in Aerosonic's annual reports on Form 10-K for fiscal years ended 1999 through 2002.

a) Aerosonic's Improper Inventory Accounting

Aerosonic's material overstatement of its inventory values from fiscal year 1999 through the first three quarters of 2003 resulted in a cumulative overstatement of inventory, and corresponding understatement of expenses, totaling approximately \$6.7 million. Aerosonic's reported inventory values and earnings were inflated primarily by its CEO and CFO's falsification of Aerosonic's inventory records. In fact, approximately \$4.2 million of Aerosonic's \$6.7 million inventory overstatement was the result of falsified physical inventory records. In each of those years, Aerosonic's CEO and CFO inflated inventory by manually adjusting Aerosonic's general ledger inventory values after those balances had been finalized through Aerosonic's year-end physical inventory process.

Aerosonic further inflated its inventory balances by failing to write down or reserve sufficiently for slow moving and obsolete inventory. Under GAAP, Aerosonic's management was required to determine reasonable estimates for its obsolete and slow moving inventory, and to record appropriate write-offs and reserves based upon those estimates. Around 1997, Aerosonic's CEO and CFO took the position that Aerosonic's inventory never became obsolete because all slow moving inventory would eventually sell or be re-engineered into salable items. Although the Company continued to record an increasing reserve for obsolete and slow moving inventory, those reserves were insufficient. McAdams expressed concern about Aerosonic's aged excess inventory to Aerosonic's CEO and CFO and to its Audit Committee as early as January 1999, and PwC recommended that the Company immediately perform a comprehensive inventory review. From fiscal year 1999 through the first three quarters of fiscal year 2003, however, McAdams knew that Aerosonic had never conducted the recommended comprehensive inventory review.

Under GAAS, McAdams was required to ensure that the Aerosonic audit teams obtained sufficient competent evidential matter and not rely upon uncorroborated management representations when it was inappropriate to do so. (AU §§ 333A.02, and 326.19a). McAdams, however, failed to ensure that the audit teams obtained sufficient competent evidential matter to support Aerosonic’s 1999 through 2002 year-end inventory values. First, McAdams failed to ensure that the audit team obtained sufficient additional evidence required to support Aerosonic’s physical inventory balances after noting material year-end book to physical inventory differences in fiscal years 2000 through 2002. Instead, McAdams accepted former senior management’s representations that the book to physical inventory discrepancies were a result of the limitations in the Company’s inventory tracking system and that those differences should be treated as a reserve. McAdams accepted management’s representations without further investigating, or requesting that Aerosonic otherwise reconcile, the discrepancies. Second, McAdams knew that the Company never performed the comprehensive inventory review that PwC recommended to senior management and the Audit Committee in 1999. Yet, McAdams relied too greatly upon Aerosonic’s inventory reports when auditing slow moving and obsolete inventory, without testing whether those reports were reliable.

b) Aerosonic Recorded Fictitious and Premature Revenue

(1) The Shreiner Transaction

During Aerosonic’s fiscal years 1999 through 2002, former senior management engaged in additional accounting schemes to inflate revenue. In violation of GAAP, Aerosonic improperly recognized revenue on a transaction with the Netherlands-based Shreiner Company (“Shreiner”) in fiscal year 1999. Specifically, Schreiner had contracted with Aerosonic to send a payment from Shreiner to a third-party vendor, less a five-percent commission paid to Aerosonic. Rather than recording only the five-percent fee, Aerosonic recognized the entire amount as revenue, and the payment through to Shreiner as an expense, resulting in a material overstatement of its fiscal year 1999 revenue. During Aerosonic’s fiscal year 1999 audit, the PwC audit team caught the accounting error. McAdams then proposed an adjustment to correct the error, which the Company recorded. Because McAdams did not review the journal posting for the transaction, and did not otherwise obtain sufficient evidential matter to support the adjustment, the audit team did not realize that the adjustment did not properly correct the Company’s books as was intended and therefore was itself erroneous. As a result, Aerosonic materially overstated its fiscal year 1999 earnings.

McAdams became aware of the erroneous Shreiner adjustment during Aerosonic’s fiscal year 2000 audit. Under GAAS, McAdams then had an obligation to either ensure that Aerosonic restated its fiscal year 1999 financial statements, or cause PwC to issue an audit report containing a qualified opinion. (AU §561.05 and .06). Instead, the Company recorded a “correcting” entry for the 1999 transaction in Aerosonic’s fiscal year 2000 financial statements. This caused Aerosonic to materially

misstate its financial statements for both fiscal year 1999 and fiscal year 2000. Yet, McAdams signed an unqualified report on the fiscal year 2000 financial statements and did not withdraw the unqualified report previously issued on the fiscal year 1999 financial statements.

(2) Meopta

Aerosonic further violated GAAP during its fiscal years 2001 and 2002 by improperly recognizing revenue and inflating inventory in connection with a sham circular sale. In the last days of its fiscal year 2001, Aerosonic sold obsolete counters to a Czech company, Meopta Optika A.S. (“Meopta”), resulting in an overstatement of Aerosonic’s 2001 income before taxes by \$397,465, or 53%. At or about the time of the Meopta “sale,” Aerosonic’s CEO arranged for the Company to repurchase the counters at an inflated price in fiscal year 2002 from Meopta’s parent company, TCI Group, over a six month period in the following fiscal year. Aerosonic placed the counters back into its inventory as they were received, which artificially inflated its fiscal year 2002 inventory values. Because the transaction lacked economic substance, Aerosonic had no basis under GAAP for recognizing revenue on the Meopta transaction or increasing its fiscal year 2002 inventory values by the counter repurchase price.

McAdams knew at the time of the 2001 audit that this significant sale had occurred in the last days of fiscal year 2001, and should have noted that it represented over half of Aerosonic’s income before taxes for the year. While McAdams requested and obtained a written confirmation from the buyer, under the circumstances, he should have done more, including, among other things, reviewing the purchase order or shipping documents related to the transaction. (AU §316.27). As a result, when Aerosonic repurchased the counters in fiscal year 2002, McAdams and his audit team failed to recognize warning signs that would have alerted them to the need to examine whether there had been a circular sale. If McAdams had required that the shipping and purchasing documents be reviewed during the 2001 audit, during the 2002 audit he could have discovered that the same number of counters that had been sold to Meopta were repurchased from TCI, and that TCI's invoice letterhead carried the same address in Czechoslovakia as Meopta. McAdams’s failure to obtain sufficient competent supporting evidence for the transaction constituted a departure from GAAS.

2. McAdams Did Not Adequately Plan and Perform Aerosonic’s Audits

For proper audit planning, GAAS requires, among other things: (1) identification of areas requiring special attention, or of special concern; (2) consideration of conditions that may require extension or modification of audit tests, such as the risk of material error or fraud, (3) incorporation of identified risks into both audit planning and audit execution, and (4) adequate communication of those risks to the audit team. (AU §§ 311.01, 311.03, and 311.06, and 312.17). McAdams’ audit planning failed to comply with GAAS because he did not ensure that known risks were properly incorporated into PwC’s Aerosonic audit plans. For example, McAdams failed to incorporate appropriate

testing for slow moving and obsolete inventory, an area that he knew was at risk for material misstatement. He also failed to ensure that the audit plan adequately addressed the audit risks presented by Aerosonic's accounting environment, such as the CEO's autocratic personality or his domination and control of management and the board of directors. Given Aerosonic's CEO's personality and control, and the materiality of Aerosonic's excess inventory, McAdams failed to exercise the appropriate attitude of professional skepticism and plan additional auditing procedures necessary to afford a reasonable basis for an opinion on the financial statements. (AU § 333.02).

3. McAdams Did Not Ensure Adequate Work Paper Documentation

Complicating the ability of PwC's audit team to catch Aerosonic's fraud from 1999 through 2002 was the lack of audit documentation detail in prior years' audit work papers. Under GAAS, the work papers must document audit procedures applied, tests performed, information obtained, and pertinent conclusions reached in the audit engagement. (AU §§ 339.02 - .03).

For Aerosonic's fiscal year 1999 through 2002 audits, McAdams permitted the engagement team member performing particular audit procedures to determine the level of documentation detail. McAdams directly reviewed a limited number of audit work papers to determine whether procedures were completed or sufficiently documented. In fact, documentation of substantive procedures in many of the 1999 through 2002 audit workpapers was inadequate. By failing to require appropriate documentation, McAdams violated GAAS and impeded PwC's ability to adequately test and determine whether Aerosonic's financial statements and adjustments complied with GAAP.

4. McAdams did not Properly Staff and Supervise the 2002 Audit

GAAS requires that audits be adequately staffed and audit assistants properly supervised, and that the auditor with final responsibility (generally the audit partner) assign tasks to, and supervise, any assistants. (AU §§ 150.02 and 230.06). Ordinarily, audit areas presenting higher risk require assignment of experienced personnel, or more extensive supervision by the audit partner during the engagement. (AU § 312.17).

McAdams, as Aerosonic's audit engagement partner, was responsible for ensuring that all of the audits were properly staffed and supervised. When the audit manager for Aerosonic's fiscal year 2002 audit began "transitioning off" that audit shortly after the initial planning phase and interim audit work, McAdams was responsible for either reassigning his tasks or assuming the tasks himself. Among the departing manager's tasks that McAdams was required to assign or assume was the more detailed review of all audit staff work. McAdams, however, neither personally performed the departing manager's detailed audit review nor assured that other staff performed the review, in violation of GAAS.

E. McADAMS ENGAGED IN IMPROPER PROFESSIONAL CONDUCT

1. McAdams Did Not Render Accurate Audit Reports on Behalf of PwC

The auditor's role is to express an opinion about whether the audited financial statements fairly present in all material respects the required information in conformity with GAAP. As the audit engagement partner, McAdams caused PwC to issue audit reports containing unqualified opinions on Aerosonic's financial statements for fiscal years ended 1999 through 2002, inaccurately representing that the financial statements were in conformity with GAAP. This was due to his failure to exercise due professional care, as described below.

2. McAdams Did Not Exercise Due Professional Care

GAAS' Third General Standard provides that "due professional care is to be exercised in the performance of the audit and preparation of the audit report." (AU § 150.02). Among other things, due professional care requires an auditor to: (1) adequately plan and properly perform the audit; (2) properly consider the audit risk that the financial statements might be materially misstated; (3) obtain sufficient competent evidence to support the assertions in the financial statements by, among other things, corroborating management representations where appropriate; and (4) maintain an attitude of professional skepticism. As described above, McAdams failed to fulfill these requirements when conducting Aerosonic's fiscal year 1999 through 2002 audits, thereby violating GAAS.

F. FINDINGS

Based on the foregoing, the Commission finds that:

In connection with the audits of Aerosonic's financial statements for fiscal years ended 1999 through 2002, McAdams engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice based upon repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

IV.

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

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

A. McAdams is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two (2) years from the date of this Order, Respondent may request that the Commission consider his reinstatement 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 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 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, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as 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.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependant 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 Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary