

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8912 / April 28, 2008

SECURITIES EXCHANGE ACT OF 1934
Release No. 57725 / April 28, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2815 / April 28, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-10998

In the Matter of

ROBERT A. PUTNAM, CPA,

Respondent.

**ORDER MAKING FINDINGS, IMPOSING A
CEASE-AND-DESIST ORDER PURSUANT TO
SECTION 8A OF THE SECURITIES ACT OF
1933, AND IMPOSING REMEDIAL
SANCTIONS PURSUANT TO RULE 102(e) OF
THE COMMISSION'S RULES OF PRACTICE**

I.

On December 23, 2002, the Securities and Exchange Commission (“Commission”) instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1) of the Commission’s Rules of Practice against Robert A. Putnam (“Putnam” or “Respondent”).¹

¹ Paragraph 1 of Rule 102(e) provides, in relevant part, that: The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter: . . . (ii) [t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct.

Following the institution of those proceedings, Putnam submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, Putnam consents to the entry of this Order Making Findings, Imposing A Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, and Imposing Remedial Sanctions Pursuant to Rule 102(e) of the Commission’s Rules of Practice (“Order”) without admitting or denying the findings set forth in this Order, except as to the jurisdiction of the Commission over him and over the subject matter of these proceedings, which are admitted.

The Commission has determined that it is appropriate to accept Putnam’s Offer and accordingly is issuing this Order.

II.

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

III.

Respondent

1. Robert A. Putnam, age 53, is a resident of Duluth, Georgia, and was a certified public accountant licensed in the State of Georgia from 1984 until December 31, 2002, when his license expired and he did not renew it. From 1984 to 2002, Putnam worked in the Atlanta, Georgia, office of Arthur Andersen LLP (“Andersen”), a national public accounting firm. At all times relevant to this proceeding, Andersen was a member of the SEC Practice Section of the American Institute of Certified Public Accountants. During all of the events described below, Putnam was a partner in the firm. From September 1996 through July 1999, Putnam served as the audit engagement partner for Andersen’s audit and quarterly reviews of HBO and Company, Inc. (“HBOC”), an Atlanta-based maker of software for the healthcare industry. Putnam also served as the audit engagement partner for Andersen’s audit of ebix.com, inc. (“Ebix”),³ a Chicago-based maker of software for the insurance industry.

Nature of Proceeding

2. This matter involves Putnam’s conduct while performing accounting services, including auditing services, for both HBOC and Ebix. In both matters Putnam failed to exercise

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.

³ At the time of the conduct at issue here, Ebix was known as Delphi Information Systems, Inc. In September 1999, the company changed its name to “ebix.com, Inc.” For the purposes of this Order Instituting Proceedings, the company is referred to as Ebix.

due professional care in the performance of the audits, failed to adequately plan and supervise the audits, and failed to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements of each company. The HBOC matter also involved a failure to follow appropriate procedures in reviews of interim financial information and consents to the use of Andersen's reports.

3. Putnam was the audit engagement partner for Andersen's audit and quarterly reviews of HBOC during 1997 and 1998. During this period, senior officers of HBOC were engaged in a fraud in which they purposefully caused HBOC to recognize revenue on transactions that failed to comply with GAAP. Through his audit and review work, Putnam received information indicating that some of HBOC's accounting for transactions did not conform to GAAP. Nevertheless, without expanding the scope of Andersen's reviews and audit, Putnam approved Andersen's issuance of six quarterly review reports and a 1997 audit report concerning HBOC financial statements filed with the Commission. On three separate occasions, Putnam met with HBOC's audit committee, but did not report any concerns that the company was failing to conform with GAAP.

4. In January 1999, HBOC was acquired by McKesson Corporation ("McKesson"), which changed its name to McKesson HBOC, Inc. ("McKesson HBOC"). HBOC became a wholly owned subsidiary of McKesson HBOC. On April 28, 1999, McKesson HBOC announced that it "had determined that software sales transactions aggregating \$26.2 million in the company's fourth quarter ended March 31, 1999, and \$16.0 million in the prior quarters of the fiscal year, were improperly recorded because they were subject to contingencies, and have been reversed. The audit process is ongoing and there is a possibility that additional contingent sales may be identified." Following this announcement, McKesson HBOC's share prices tumbled from approximately \$65 to \$34 a share, a decline of more than \$9 billion in market value. McKesson HBOC later restated its financial results for the prior three fiscal years, primarily due to the fraud that occurred at HBOC. In total, the restatement reduced previously reported revenues by approximately \$ 327.4 million.

5. Putnam served as the audit engagement partner for Andersen's audit of Ebix for the nine-month period ended December 31, 1998 ("1998 transition period").⁴ During his audit work for the company, Putnam received indications of possible fraud at Ebix including earnings management, high involvement in accounting decisions by non-financial management, commitments made to analysts, the expectation of possible equity funding, the desire to maintain a high stock price, Ebix's very aggressive accounting policies, and possible opinion shopping by Ebix among accounting firms, among others. In particular, Putnam became aware that Ebix's management had taken an extremely aggressive approach to recognizing revenue from the company's software sales.

6. In 1998, one of Ebix's products was a software program it marketed to the insurance industry called "cd.global." While auditing Ebix's revenues and accounts receivable

⁴ In March 1998, Ebix changed its fiscal year-end from March 31 to December 31, thus requiring the company to file a Form 10-K with the Commission for the nine-month period which commenced April 1, 1998 and ended December 31, 1998.

for the 1998 transition period, Putnam learned that a number of Ebix's cd.global customers stated that they had not accepted the cd.global software for various reasons. Under GAAP, a software vendor cannot recognize revenue on the sale of software the customer has not yet accepted. Despite his awareness of the customers' complaints and their stated non-acceptance of the cd.global product, Putnam failed to properly investigate the matter, and permitted Ebix to recognize revenue on its purported sales of cd.global. Putnam then authorized the issuance of Andersen's unqualified audit opinion on Ebix's 1998 transition period financial statements, which included significant revenue relating to the purported cd.global sales.

7. Ebix's original financial statements for the 1998 transition period, filed with the Commission in April 1999, reported revenue of \$19.2 million, and net income of \$523,000. In June 2000, Ebix filed revised and restated financial statements with the Commission for the 1998 transition period. The revised and restated financial statements reported revenue of \$13.4 million and a net loss of \$5.5 million for the 1998 transition period. Thus, Ebix's original financial statements, as audited by Putnam, overstated Ebix's revenues by \$5.8 million, or approximately 43 percent, and overstated Ebix's income by approximately \$6 million. Over \$3.4 million of the overstated revenue on Ebix's original financial statements was revenue that Ebix had improperly recognized for sales of cd.global and related services.

Putnam's Conduct in the HBOC Matter

8. HBOC principally sold large integrated healthcare management software systems. In its press releases, HBOC separately reported revenue from software sales. HBOC established an exceptional earnings track record. In each quarter between January 1996 and September 1998, HBOC beat quarterly earnings per share estimates by at least \$.02 per share.

9. Andersen considered HBOC a high risk client during 1997 and a maximum risk client during 1998. Despite this assessment, Putnam failed to design review and audit procedures commensurate with the level of risk Andersen identified at HBOC. Putnam also failed to exercise due care in the conduct of Andersen's reviews and audits by, among other things, failing adequately to expand the scope of the reviews and audits as required under Generally Accepted Auditing Standards ("GAAS") in light of significant errors and other indications that HBOC was not accounting for specific transactions in conformance with GAAP. In particular, Putnam failed to expand the scope of Andersen's work despite red flags that HBOC's management had failed to fulfill promises to comply with GAAP and continued to recognize revenue on contracts with contingent terms for software sales to customers in side letters.

10. A side letter or side agreement is any document or oral agreement containing contract terms that are not a part of the formal contract. Andersen audit bulletin number 96-18 (issued in 1996) warned its audit staff that side letters often are the cause of material revenue misstatements, especially in the software industry. HBOC's use of side letters increased the audit risk because it heightened the potential for key contract terms affecting revenue recognition (revenue contingencies) to be overlooked or deliberately hidden as part of a revenue recognition fraud. Putnam had reason to be aware as early as 1996 that HBOC used side letters in its contract negotiations with customers.

The 1997 Quarterly Reviews

11. Beginning with his review of HBOC's interim financial statements for the first quarter of 1997, Putnam learned that HBOC's management took the position that revenue could be recognized on certain contracts where a software sale was contingent on later approval by a customer's board of directors (a "board contingency"). Under GAAP, it is improper to recognize revenue on such a transaction until the contingency is satisfied. For example, some of HBOC's software sales contracts were contingent upon approval by the customer's board of directors (a "board contingency") and therefore those contracts were not enforceable by HBOC until the customer's board of directors actually approved the contracts. Under GAAP, a company may not report revenue on any sales contract if the contract is unenforceable or performance of the contract by the customer is in doubt. Putnam discussed this issue with Jay Gilbertson ("Gilbertson"), HBOC's chief financial officer, who claimed that such board contingencies were merely perfunctory and that there was no real risk that the customer would cancel a contract based on such a contingency. Gilbertson promised to provide some sort of documentation to support his claim, but he never did so.

12. During the 1997 quarterly reviews, Putnam had reason to be skeptical concerning HBOC's accounting practices with respect to software revenue recognition. Andersen, during its audit of HBOC's 1996 year-end financial statements, identified at least one instance where a board contingency was not contained in the contract, but instead in a side letter, and revenue had been recognized.

13. Putnam also had reason to be concerned regarding the integrity of HBOC's management. In three of four quarters in 1997, Gilbertson represented in writing to Andersen that HBOC had complied with the latest draft of the new software revenue recognition guidelines that specifically prohibited revenue recognition if any board contingency existed. The new authoritative literature, Statement of Position No. 97-2 ("SOP 97-2"), entitled Software Revenue Recognition, effective January 1, 1998, specifically precluded revenue recognition if board contingencies existed. Andersen's review and audit work in the same period had revealed that HBOC had continued to enter into some contracts with board contingencies.

14. Throughout 1997, HBOC's management made public announcements of the company's revenues, net income and earnings per share prior to the completion of Andersen's audits or reviews. Putnam was aware of this practice.

Andersen's Review of HBOC's Financial Statements for the First Quarter 1997

15. HBOC reported software revenue of \$68 million in the first quarter of 1997 ("Q1 1997"). During the first quarter review, Putnam's audit team tested whether the company had properly recorded revenue on \$29 million in software sales and found that the company had improperly recorded revenue totaling \$14 million. This was a 48 percent error rate. According to the Andersen working papers, HBOC overstated pretax income by 9.4 percent. Most of the improperly recorded revenue related to contracts that were subject to board contingencies. Andersen's auditors also found an instance where HBOC had recognized revenue on a software contract signed after quarter end. GAAP requires that revenues must be reported in the fiscal

period in which they occur. HBOC's management refused to eliminate this improperly recorded revenue from its financial statements for the first quarter of 1997.

16. Putnam approved Andersen's quarterly review report for the first quarter 1997, which was incorporated into HBOC's Form 10-Q filed with the Commission. Among other things, Andersen's report stated: "We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. . . . Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles."

17. HBOC's improper recording of revenue and other accounting errors in the first quarter of 1997 was material information for the company's stockholders. In its quarterly earnings releases, HBOC reported software revenue as a separate line item. HBOC's software revenue for the quarter was overstated by 21 percent. In addition, HBOC's reported net income was overstated by 10.3 percent.

18. Andersen's review for the first quarter of 1997 revealed accounting errors that were dramatically higher than previous periods. Despite the significant increase in the errors found, Putnam did not direct his team to make additional inquiries or employ other procedures for that quarter.

Andersen's Review of HBOC's Financial Statements for the Second Quarter 1997

19. In the 1997 second quarter review, Putnam learned that HBOC continued to recognize revenue on certain contracts containing board contingencies. He also learned that HBOC recorded revenue improperly on software sales subject to other types of contingencies including subsequent management or legal approval or a right to cancel the contract at a future date. Moreover, Putnam learned that HBOC senior executives had written some of these contingencies in side letters. Putnam learned that at least one HBOC contract included in first quarter revenue had been canceled when a customer's board of directors failed to approve the deal. Additionally, Putnam's audit team found another instance where HBOC had recognized revenue on a contract that had not been executed until after quarter end. Andersen recommended to HBOC's management that the revenue from these contingent contracts be reversed.

20. Gilbertson again refused to make any adjustments in HBOC's financial statements to correct these errors. The errors were material to HBOC's financial statements in both type and amount. Based on these errors, the pretax income and net income reported by HBOC in its earnings release and Form 10-Q were overstated by approximately 12 percent and HBOC's reported software revenue was overstated by almost 7 percent.

21. Despite the accounting errors found in the second quarter review, and despite HBOC's continued practice of putting revenue contingencies into side letters, Putnam did not direct his team to make additional inquiries or employ other procedures for the quarter.

22. Putnam approved the issuance of Andersen's unqualified quarterly review report for the second quarter 1997, which was incorporated into HBOC's Form 10-Q filed with the Commission. Among other things, Andersen's report stated: "We conducted our review in

accordance with standards established by the American Institute of Certified Public Accountants.... Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles.”

Andersen’s Review of HBOC’s Financial Statements for the Third Quarter 1997

23. In the third quarter of 1997, Putnam and his audit team continued to find instances where HBOC recognized software revenue despite the existence of contingencies in the sales contracts. The auditors found some contingencies in side letters written by HBOC senior sales executives. Despite this, Putnam did not direct his team to make additional inquiries or employ other procedures to test software revenue. Andersen proposed to HBOC’s management that the company make adjustments for certain errors found equal to 7 percent of pretax income. Gilbertson refused to make these adjustments. Putnam did not pursue the issue further.

24. The accounting errors in HBOC’s financial statements for the third quarter of 1997 were material both in type and amount. The 1999 investigation in connection with McKesson HBOC’s restatement revealed that HBOC, in its earnings release and Form 10-Q report for the third quarter, overstated software revenue, pretax and net income by 15.5 percent, 15 percent and 15 percent, respectively, based on these errors.

25. Putnam authorized the issuance of Andersen’s unqualified quarterly review report for the third quarter 1997, which was incorporated into HBOC’s Form 10-Q filed with the Commission. Among other things, Andersen’s report stated: “We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants... . Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles.”

Andersen’s Audit of HBOC’s Financial Statements for the 1997 Year End

26. Andersen conducted an audit of HBOC’s financial statements for the year ended December 31, 1997. Putnam was the engagement partner for this audit. The audit staff included a manager and two associates. In addition, Andersen assigned a concurring partner to review the results of the audit work. Field work for the audit was completed on February 6, 1998. On March 9, 1998, Andersen issued an audit report concerning HBOC’s 1997 financial statements and expressed an unqualified opinion concerning those financial statements. Andersen’s audit report was dated February 6, 1998.

Failure to Adequately Test and Confirm Software Revenue

27. Andersen’s audit included testing of HBOC’s software revenue and trade accounts receivable. The audit confirmation process was the primary audit test performed by Putnam and his staff to ensure the completeness of HBOC’s customer contract files. Andersen sent eight audit requests for confirmation of accounts receivable (eleven fewer than sent during the 1996 audit) to selected HBOC customers. The confirmation requests asked the customers to confirm any amounts owed to HBOC and that no revenue contingencies existed on software

purchased from HBOC. Only three customers responded, two noting contingencies that were contained in side letters (a 66 percent exception rate).

28. Although two customers had responded to Andersen that side letter contingencies existed in their contracts, Putnam did not direct his staff to send out any additional confirmations confirming software sales for this period to see if there were additional contingencies or other problems that would further affect HBOC's financial statements. Putnam did not direct his staff to perform any other additional testing to ensure that HBOC's contract files were complete. Putnam and his staff did not significantly test the flow of documentation from the sales department to the contract files maintained in the accounting department. Putnam and his staff did not check with the sales department to find out if it possessed any other sales documents not forwarded to the accounting department. Putnam and his staff did not gain a full understanding of HBOC's policies or practices for using side letters. Putnam and his staff did not ask whether HBOC maintained a listing of side letters. Finally, Putnam and his staff did not obtain representations from HBOC's sales personnel concerning the existence of other side letters.

Failure to Examine Other Accounting Improprieties

29. During the 1997 audit, Putnam and his staff also identified other accounting improprieties at HBOC. These included the premature recognition of revenue on software maintenance arrangements and the accrual of excessive acquisition reserves (so called "cookie jar" reserves).

30. HBOC sold many of its software systems together with a service agreement for periodic maintenance. Under these software maintenance arrangements, HBOC provided maintenance over a period of years. HBOC customers typically paid a lump sum during the first year of the contract, which covered both the software license and the service and maintenance provided in future years. GAAP requires that revenue that is to be earned over a period of years be deferred until earned or when the service and maintenance is provided. Putnam told Gilbertson that HBOC was recognizing too much maintenance revenue and that the company needed to increase the percentage of maintenance revenue it deferred. Gilbertson refused to make Andersen's proposed adjustment to correct the premature recognition of revenue. Instead, Gilbertson promised Putnam that he would increase HBOC's deferral percentage in following quarters until it was adequate.

31. During 1997, HBOC acquired other companies and, in its accounting for these acquisitions, HBOC allocated funds for expected future costs and expenses of the acquisitions. These "acquisition reserves" totaled \$ 95.3 million. Andersen audited the acquisition reserves and concluded that HBOC's reserves were \$ 16 million greater than was needed. Andersen proposed to HBOC's management, in accordance with GAAP, that \$ 16 million should be reversed. HBOC's management refused to make the adjustment, but promised Andersen that it would only use the reserve for acquisition related costs. Putnam did not pursue the matter further. The amount of the excessive acquisition reserves was material. Those reserves overstated HBOC's reported nonrecurring expenses by 20 percent.

32. On or about March 9, 1998, Putnam authorized Andersen to issue its audit report for HBOC's year ended December 31, 1997. In its report, Andersen stated: "We conducted our audits in accordance with generally accepted auditing standards. . . . In our opinion, the financial statements referred to above present, fairly, in all material respects, the financial position of HBO & Company and subsidiaries... in conformity with generally accepted accounting principles."

Putnam Did Not Fully Inform HBOC's Audit Committee Concerning the Results of the Reviews and Audit

33. Putnam met with HBOC's audit committee in November 1997 and again in February 1998. At neither meeting did Putnam inform the audit committee that HBOC was misapplying GAAP, except that Putnam informed the audit committee that HBOC was recognizing too much maintenance revenue and that the company needed to increase the percentage of maintenance revenue it deferred. Nor did Putnam report his disagreements with Gilbertson regarding these practices. Instead, at each meeting Putnam reported that Andersen found no significant problems or exceptions and that Andersen enjoyed the full cooperation of HBOC management. Putnam also informed the audit committee that HBOC was in compliance with the new authoritative literature governing software revenue recognition. Putnam failed to disclose to the audit committee that HBOC's practice of booking software sales when board and other revenue contingencies existed was directly contrary to GAAP. Further, Putnam failed to inform the audit committee that Andersen had identified not only board contingencies but other types of revenue contingencies at HBOC and that these contingencies were sometimes found in side letters.

34. Sometime after the February 1998 audit committee meeting, Andersen drafted a letter to HBOC's management, which Putnam reviewed. Among other topics, the letter recommended that HBOC forbid its senior sales executives and sales representatives from entering into side letter contingencies. Putnam's staff delivered a copy of the draft letter to HBOC's management but did not provide a copy of the draft letter to the audit committee or inform the audit committee of its contents. Putnam did not sign or deliver a final version of the letter to HBOC's management.

Andersen's Review of HBOC's Financial Statements for the First Quarter 1998

35. Andersen conducted a review of HBOC's interim financial statement for the quarter ended March 31, 1998. During this first quarter review, Putnam discovered that HBOC was misusing the acquisition reserve it accrued during 1997 to offset current period operating expenses. This use of the acquisition reserve did not conform with GAAP and had the effect of overstating HBOC's reported net income. Such use of the acquisition reserve was contrary to the representations of HBOC management to Putnam about how HBOC would use these reserves.

36. During the first quarter review, Putnam and his team identified another instance where HBOC had recognized revenue despite the existence of a revenue contingency contained in a side letter. The side letter was signed by HBOC's senior vice president of sales. Putnam

proposed that the revenue from this transaction be reversed, but Gilbertson refused. Once again, Putnam did not expand the scope of Andersen's testing to see if there were additional side letters containing revenue contingencies. Putnam and his team did not document in its working papers any explanation why a software transaction containing a contingency was recorded as revenue, nor did they obtain any explanation for why the senior vice president of sales entered into a side letter that contained a revenue contingency despite Andersen's written recommendation to stop doing so.

37. Putnam approved the issuance of Andersen's unqualified quarterly review report for the first quarter of 1998, which was incorporated into HBOC's Form 10-Q filed with the Commission. Among other things, the report stated: "We [Andersen] conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. ...Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles."

38. By approximately April 1998, the engagement manager on the HBOC account (Putnam's direct subordinate on the HBOC account) became concerned that HBOC was managing earnings through its non-GAAP accounting. On several occasions, the engagement manager stated these concerns to Putnam. Putnam shared these concerns.

39. In May 1998, Putnam and his engagement team called a special meeting with Gilbertson and others at HBOC to again reiterate that HBOC needed to correct its non-GAAP accounting practices. In response to Putnam's criticisms in the 1997 year-end audit, Gilbertson repeated promises to correct HBOC's non-GAAP practices, including deferring the appropriate revenue relating to software maintenance arrangements and using acquisition reserves only to offset acquisition related expenses.

Andersen's Review of HBOC's Financial Statements for the Second Quarter 1998

40. Andersen conducted a review of HBOC's interim financial statements for the quarter ended June 30, 1998. During this second quarter review, Andersen discovered a number of accounting errors. Andersen found that HBOC had again applied its acquisition reserves to current expenses, that HBOC continued to recognize too much revenue from software maintenance arrangements, and that HBOC had understated its allowance for doubtful accounts. Putnam told Gilbertson that if HBOC did not reverse the application of the acquisition reserves, Andersen would not issue its review report. After a heated discussion, Gilbertson agreed to reverse the recording of current expenses against the acquisition reserve. Putnam however, did not confront HBOC management on the other accounting errors Andersen found and HBOC made no correcting entries for those items. These remaining accounting errors were material in amount and overstated HBOC's reported pretax income for the quarter by 5.45 percent, not including the understatement for doubtful accounts. Nonetheless, Putnam did not direct his team to make additional inquiries or employ other procedures for the quarter.

41. Putnam approved the issuance of Andersen's unqualified quarterly review report for the second quarter of 1998, which was incorporated into HBOC's Form 10-Q filed with the

Commission. Among other things, the report stated: “We [Andersen] conducted our review in accordance with standards established by the American Institute of Certified Public Accountants.... Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles.”

Andersen’s Review of HBOC’s Financial Statements for the Third Quarter 1998

42. Andersen conducted a review of HBOC’s interim financial statements for the quarter ended September 30, 1998. During that quarter review, Andersen discovered that HBOC prematurely recognized revenue on software maintenance arrangements because Gilbertson had not increased HBOC’s deferral percentage as he had promised. Andersen proposed a \$9.5 million adjustment for this error. Andersen also proposed an adjustment to increase the reserve for bad debt by \$4.5 million. Ultimately, HBOC did not make the proposed adjustments and Putnam did not pursue the issue. Based upon this error, HBOC overstated net income by \$14 million for the nine months ended September 30, 1998. This overstatement was material in amount. This was 11 percent of HBOC’s reported pretax income and net income for the quarter or 3.8 percent of HBOC’s reported pretax income and net income for the nine-month period.

43. During the third quarter of 1998, based in part upon Gilbertson’s representation that there were two transactions, Putnam approved HBOC’s accounting for a transaction in which HBOC sold \$30 million of its software and purchased \$74 million of the same customer’s product. Although documented as separate transactions, both the transactions were entered into on September 28, 1998 (two days before the end of the third quarter). HBOC recorded \$30 million as a sale of software to the customer in the third quarter of 1998 and included that amount in its reported revenue for the quarter. The transaction accounted for 20 percent of software revenue recorded during the quarter. By recording \$30 million in revenue from the transaction, HBOC reported earnings of 19 cents per share, thus exceeding the consensus expectation of Wall Street analysts that HBOC would earn 18 cents per share in the quarter. Without the revenue from this transaction, HBOC could only have reported earnings of 16 cents per share.

44. While the transaction was still being negotiated, Putnam had several conversations with HBOC management about the structure of the deal. HBOC had never before entered into a reseller arrangement of this magnitude, nor had it ever entered into an arrangement where it was simultaneously selling and purchasing product from the same company. In a discussion with Gilbertson, Putnam advised that this accounting for the transfer of HBOC software to the customer would be correct if (a) the two transactions were not linked; and (b) there was a defined end-user for the HBOC software. Gilbertson assured Putnam that the sale and purchase from the customer were independent of each other, and that the customer was donating the \$30 million of software to charity hospitals, who were the end users. Both of these statements by Gilbertson were false. In fact, the two transactions were completely dependent on each other, and the customer had no intention of donating \$30 million of software. Instead, the customer expected HBOC to assist it in reselling the product to end-users.

45. Putnam had reason to know that Gilbertson's statements about the key elements of the transaction were false. HBOC had never before entered into a reseller arrangement of this magnitude and the transaction accounted for more than 20 percent of the net income for the period. Although documented in two separate contracts, both the contract for HBOC's sale to the customer and the contract for the purchase from the same customer were signed on the same day (two days before quarter end). Finally, Gilbertson's explanation that the customer intended to donate \$ 30 million of highly complex software was so extraordinary and unusual that Putnam reasonably should have confirmed the information with the customer.

46. Putnam approved the issuance of Andersen's unqualified quarterly review report for the third quarter of 1998, which was incorporated into HBOC's Form 10-Q filed with the Commission. Among other things, the report stated: "We [Andersen] conducted our review in accordance with standards established by the American Institute of Certified Public Accountants.... Based on our review, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with generally accepted accounting principles."

47. In July 1999, McKesson HBOC restated HBOC's revenues for the third quarter of 1998 and eliminated the \$30 million transaction.

Putnam Failed to Fully Advise HBOC's Audit Committee of Andersen's Findings

48. Putnam attended a November 1998 meeting of HBOC's audit committee, where HBOC's Chairman informed the audit committee that Gilbertson was resigning from his position as CFO of HBOC. Gilbertson's resignation was unexpected. The HBOC Chairman asked Putnam if he had a "Cendant on his hands." Cendant was a widely-reported financial fraud case. In response to the Chairman's question, Putnam responded that he didn't know of anything. Putnam did not report to the audit committee his continued disagreements with Gilbertson regarding HBOC's accounting, Gilbertson's failure to make good on promises to Andersen with respect to acquisition reserves and maintenance revenue, repeated discoveries by Andersen of contingencies in its sales contracts that affected revenue recognition, any problems with HBOC's internal controls and management, nor any of the myriad other accounting errors and non-GAAP accounting that Andersen had found over numerous periods.

Andersen Consented To Use Of Its Reports in McKesson's Registration Statements

49. In October 1998, McKesson and HBOC announced that McKesson would acquire HBOC. In preparation for the acquisition, McKesson made several filings with the Commission. On October 30 and November 13, 1998, McKesson filed registration statements on Forms S-3 and S-4, respectively. On November 23 and 27, 1998, McKesson filed amendments to its Form S-3 and Form S-4 registration statements, respectively. Included in each of these McKesson filings was Andersen's consent to incorporation by reference of its report dated February 6, 1998 with respect to HBOC's consolidated financial statements for the period ended December 31, 1997. Putnam approved Andersen's consent to the use of its report in these McKesson filings. Despite a number of accounting errors that affected Andersen's February 6, 1998 report, Putnam

did not investigate the impact of such errors on HBOC's financial statements as of December 31, 1997 and did not insist on appropriate revision of Andersen's report.

Andersen's Work on HBOC's Quarter Ended December 31, 1998

50. In December 1998, less than a month after his report to HBOC's audit committee, Putnam met with other Andersen personnel to discuss the HBOC engagement. In connection with the audit planning of HBOC during the summer of 1998, Andersen assessed HBOC as a maximum risk client. In accordance with Andersen's internal risk policy an annual consultation was required for all audit clients given a maximum risk rating. The consultation included an exercise involving a "what if" fraud risk assessment. In an outline attached to a memo to the file, dated December 7, 1998, the engagement manager assigned to HBOC documented the "what ifs" that were to be discussed at the meeting. Among other things the memo stated:

Fraud would be reflected in the financial statements in the area . . . of improper revenue recognition, . . . intentional understatement of the accounts receivable reserve . . . and (other) indications of aggressive GAAP (which may be a prelude to fraud) including acquisition reserves and deferred maintenance. Analyst commitments (no missed earnings for 28 consecutive quarters) . . . and instances of side agreements.

51. The topics addressed in the memo were precisely the types of items that would later cause the massive restatement. Yet, Putnam never adequately disclosed these concerns to HBOC's audit committee.

52. In preparation for a 1998 year-end audit of HBOC, Andersen tested a portion of HBOC's accounts receivable in each quarter by requesting that certain customers confirm the amounts they owed to HBOC and that there were no contingencies in their sales contracts. As discussed above, customer responses to these requests revealed that HBOC entered into sales contracts and recorded revenue on those sales although the contracts contained contingencies. In approximately August 1998, Andersen received a response from an HBOC customer sent out in the second quarter of 1998 in which the customer noted the existence of a side letter containing revenue contingencies. Although the response from the customer was included in Andersen's working papers for the quarter, Andersen did not pursue the issue with either HBOC or the customer.

53. Later, Putnam and his team identified numerous other side letters containing revenue contingencies and instances where revenue had been improperly recognized in the first three quarters of 1998. Despite these red flags, Putnam approved Andersen's consent to McKesson's use of Andersen's February 6, 1998 report on HBOC's 1997 financial statements in its registration statements filed in October and November 1998.

54. In January 1999 McKesson Corporation completed its acquisition of HBOC. McKesson told Andersen that it would not be necessary for Andersen to complete the audit for the period ended December 31, 1998, but asked Andersen to perform certain of the procedures

that would have been done had the audit been completed. Putnam was the engagement partner for this work.

55. During the work related to year-end 1998, Putnam learned that HBOC had entered into more side letters with contingencies and improperly recorded revenue from those transactions. Nonetheless, Putnam did not require his team to investigate the extent of contingencies affecting contracts recorded in prior periods and to expand the scope of its procedures to attempt to identify other contract contingencies and improper revenue recognition.

56. In or about April 1999, McKesson engaged Andersen to conduct an audit of HBOC's financial statements for periods ended March 31, 1997 and March 31, 1998. Putnam was the engagement partner for this work. Putnam approved a report by Andersen, dated July 12, 1999, concerning HBOC's March 31, 1997 and March 31, 1998 financial statements. Andersen expressed an opinion that HBOC's financial statements presented fairly, in all material respects, the financial position of HBOC as of those dates and the results of operations and their cash flows for the years then ended in conformity with GAAP.

57. On July 14, 1999, McKesson HBOC filed an annual report on Form 10-K including consolidated financial statements for the companies and its subsidiaries as of March 31, 1997, March 31, 1998 and March 31, 1999. The company also reported restatements of certain income statement items for quarters in 1997 and 1998. For the year ended March 31, 1998, McKesson reported that \$39.7 million in revenues was improperly reported due to improper application of SOP 91-1 and \$19 million in contingent revenues were improperly recognized in prior filings by HBOC. For the three-month period ended June 30, 1998, McKesson reported that \$25.8 million in revenues was improperly reported due to improper application of SOP 97-2 and \$32.6 million in contingent revenues were improperly recognized in prior filings by HBOC. For the three month period ended September 30, 1998, McKesson reported that \$20.8 million in revenues was improperly reported due to improper application of SOP 97-2 and \$22.9 million in contingent revenues were improperly recognized in prior filings by HBOC. For the three-month period ended December 31, 1998, McKesson reported that \$33.7 million in revenues was improperly reported due to improper application of SOP 97-2 and \$48.8 million in contingent revenues were improperly recognized in prior filings by HBOC. McKesson adjusted for these errors in its consolidated financial statements.

58. Putnam approved Andersen's consent to the inclusion of its July 12, 1999, audit report in McKesson's Form 10-K filing.

Summary

59. In performing the HBOC quarterly reviews and annual audit, Putnam failed to comply with GAAS, through his acts and omissions including but not limited to:

- a. Failing to comply with generally accepted auditing standards in planning the work, adequately supervising the work performed, and failing to obtain a sufficient understanding of internal controls to plan the audit and to determine the nature and extent of tests to be performed;

- b. Failing to exercise due professional care and maintain an attitude of professional skepticism to provide reasonable assurance of detecting both material errors and fraud in the financial statements;
- c. Failing to obtain sufficient competent evidential matter to afford a reasonable basis for Andersen's opinion regarding the financial statements of HBOC;
- d. Failing to follow appropriate procedures in reviews of interim financial information;
- e. Failing to follow appropriate procedures for consents to the use of Andersen's reports;
- f. Failing to follow appropriate procedures for communications with HBOC's audit committee;
- g. Failing appropriately to consider and assess the risk of material misstatement due to fraud and fraud risk factors;
- h. Failing to have a sufficient basis for Andersen's statements in its quarterly review reports that the firm was not aware of any material modifications that should be made to HBOC's financial statements for them to conform to GAAP;
- i. Failing to have a sufficient basis for Andersen's opinion that the firm's audit of HBOC's financial statements had been performed in accordance with GAAS.

Putnam's Improper Professional Conduct in the Ebix Audit

Ebix's Business

60. Ebix developed and marketed, through the use of license agreements, multi-function software for the insurance industry. In the latter half of 1998, Ebix began marketing a software product called "cd.global" to its U.S. and Canadian customers. Cd.global was a highly sophisticated, complex program, which required a significant amount of customization and installation before the customer could use the program. Among other things, cd.global was supposed to allow electronic exchange of policy information between insurance agencies and insurance carriers, and to convert such information into the standard forms used in the insurance industry. These particular functions of cd.global were known as "AL3" in the domestic version and "CSIO" in the Canadian version.

Increased Audit Risk Related to Ebix

61. Auditors are required to exercise professional skepticism when performing audit procedures.

62. Putnam became the engagement partner for Andersen's audit of Ebix's 1998 transition period financial statements in or about March 1999, replacing the first engagement

partner who had been assigned to the 1998 transition period audit. At the time Putnam became Ebix's audit engagement partner, the previous engagement partner had been involved in a series of meetings and discussions with Ebix's management concerning various revenue recognition issues encountered during the audit process. The previous engagement partner had recommended several downward adjustments to the revenue that Ebix had recognized on its 1998 transition period financial statements. Over \$3.4 million of the overstated revenue on Ebix's original 1998 transition period financial statements was sales and service revenue that Ebix had improperly recognized concerning its cd.global product.

63. Soon after Putnam became the Ebix engagement partner, the Andersen audit staff under his supervision prepared a memorandum dated March 15, 1999. The March 15, 1999 memorandum recounted that during the audit process, Andersen had a number of concerns related to Ebix's positions on accounting matters, and, in particular, on Ebix's handling of revenue recognition on software sales. The memorandum noted that Ebix's management had taken "an extremely aggressive approach" in interpreting relevant GAAP standards relating to "a significant amount of software revenue recognized."

64. In addition to noting Ebix's extremely aggressive approach to software revenue recognition, the March 15, 1999 memorandum also observed that Andersen became aware of a number of factors that increased the risk of fraud in Ebix's financial statements:

The fraud indicators relate to such areas as possible earnings management, high involvement in accounting decisions by non-financial management (i.e. CEO), commitments made to analysts, expectation of possible equity funding, desire to maintain a high stock price, very aggressive accounting policies, possible "opinion shopping," disputes over adjustments, etc.

65. The March 15, 1999 memorandum further stated that due to the existence and nature of the fraud indicators described above, Andersen had "modified our audit approach to substantially increase the amount of audit work we perform in the revenue recognition area." These modifications would include, among other things, "substantial contract confirmation work" and "review of all contracts entered into during the year."

The Failed Cd. Global Contract Confirmation Process

66. During its 1998 transition period, Ebix entered into approximately thirty license agreements with its U.S. and Canadian customers for cd.global software. In conducting the audit, Putnam and the audit team sent written confirmations to sixteen Ebix customers who had purchased cd.global in the 1998 transition period to verify information concerning those license agreements. Andersen received ten responses to its confirmation requests; seven of these were "negative," i.e., indicated that the customer took exception to the information being confirmed.

67. In general, each of Ebix's cd.global license agreements contained similar provisions concerning the customer's obligation to pay for the software, which conditioned payment on the successful installation and implementation of cd.global. The license agreements generally conditioned the customer's obligation to pay for the software upon, among other

things, a successful test conversion of the customer's data from its existing system to the cd.global data format, and upon full functionality of cd.global, including the AL3/CSIO component of the software. Despite these common provisions in the cd.global license agreements, Andersen's confirmations completely failed to address these pre-conditions to payment. For example, none of the confirmations sent to cd.global customers requested information concerning, among other things, the date upon which a successful test conversion of the customer's data to the cd.global data format had occurred, the number of individual "seat licenses" accepted by a customer, or the date upon which the software's AL3/CSIO component had become functional.

68. Under Paragraph 20 of SOP 97-2, "[a]fter delivery, if uncertainty exists about customer acceptance of the software, license revenue should not be recognized until acceptance occurs."

69. Each of the seven negative responses to Andersen's confirmation requests indicated that Ebix's customers had not yet accepted the cd.global software due to functionality problems with the software. In addition, one confirmation response indicated that a customer had not accepted the number of individual "seat licenses" represented by the invoices for which Andersen sought confirmation.

70. Despite the negative cd.global customer responses to Andersen's confirmations, Putnam failed personally to contact, or to have his staff contact, any of the customers who responded to the confirmations. Nor did Putnam ask for, or review, Ebix's customer correspondence files to further investigate the nature of the problems raised by the confirmation process. Putnam did not attempt to seek further information concerning the acceptance of the cd.global software from any independent source. Instead, Putnam relied on Ebix's management's representation that the cd.global software was fully functional, and allowed Ebix to recognize significant revenue from purported sales of cd.global in the 1998 transition period, including revenue from the customers who had submitted negative responses to Andersen's confirmations. In so doing, Putnam failed to exercise an appropriate degree of professional skepticism and critical assessment of audit evidence in performing the Ebix audit.

71. On April 15, 1999, Ebix filed with the Commission a Form 10-K for the nine-month period ended December 31, 1998. Ebix included financial statements in this Form 10-K that reported revenue of \$19.2 million and net income of \$523,000. The financial statements were accompanied by an Arthur Andersen audit report containing an unqualified opinion (with a going concern emphasis paragraph) that Ebix's financial statements presented fairly, in conformity with generally accepted accounting principles, the results of Ebix's operations for that period.

72. On June 1, 2000, Ebix filed an amended Form 10-K containing revised and restated financial statements for the 1998 transition period. In the restatement, Ebix reported revenue of \$13.4 million, and a net loss for the period of \$5.5 million. Consequently, the original financial statements overstated Ebix's revenue by \$5.8 million, or approximately 43 percent, and overstated Ebix's net income by approximately \$6 million.

73. The customers providing negative responses disputed a total of \$638,955 that Ebix claimed they owed December 31, 1998. In its restatement, Ebix reversed over \$1.2 million in revenues improperly recognized from the customers that provided negative responses to confirmation requests.

Summary

74. In performing the Ebix audit, Putnam failed to comply with GAAS, through his acts and omissions including but not limited to:

- a. Failing to comply with GAAS in planning the work, adequately supervising the work performed, and failing to obtain a sufficient understanding of internal controls to plan the audit and to determine the nature and extent of tests to be performed;
- b. Failing to exercise due professional care and maintain an attitude of professional skepticism to provide reasonable assurance of detecting both material errors and fraud in the financial statements;
- c. Failing to obtain sufficient competent evidential matter to afford a reasonable basis for Andersen's opinion regarding the financial statements of Ebix;
- d. Failing to create, to implement, to evaluate, and to interpret a confirmation process that would have led to the detection of improperly recognized revenue;
- e. Failing appropriately to consider and assess the risk of material misstatement due to fraud and fraud risk factors;
- f. Issuing an audit report containing an unqualified opinion without performing audit steps sufficient to provide a basis for that opinion; and
- g. Failing to have a sufficient basis for Andersen's opinion that Ebix's financial statements conformed to GAAP, specifically SOP 97-2, relating to the recognition of revenue.

Violations of the Federal Securities Laws and Rule 102(e)

75. In connection with the audits and reviews of the financial statements of HBOC, as described above, Putnam was a cause of one or more of HBOC's violations of Section 17(a)(2) and (3) of the Securities Act.

76. Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides that the Commission may deny the privilege of appearing or practicing before it to any person who is found to have engaged in improper professional conduct. With respect to persons licensed to practice as accountants, "improper professional conduct" may include negligent conduct evidenced by "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.” Rule 102(e)(1)(ii), Rule 102(e)(1)(iv)(B)(2).

77. In connection with the audits and reviews of the financial statements of HBOC and Ebix, as described above in Paragraphs 59 (a) through (i) and 74 (a) through (g), Putnam engaged in improper professional conduct by repeatedly engaging in unreasonable conduct, resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission.

Findings

78. Based upon the foregoing, the Commission finds that Respondent Putnam was a cause of one or more of HBOC’s violations of Section 17(a)(2) and (3) of the Securities Act.

79. Further, based upon the foregoing, the Commission finds that Respondent Putnam engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

IV.

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

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

- A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and (3) of the Securities Act;
- B. Respondent is denied the privilege of appearing or practicing before the Commission as an accountant.
- C. After five 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 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 or, if the Board has not conducted an inspection, has received an unqualified report relating to his, or the firm's, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions;
- 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.

D. 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 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 Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary