SEC Hits Hard on Executive Perks

by Marc Fagel & Shailey Jain, Gibson Dunn & Crutcher

On March 31, the Securities and Exchange Commission filed a litigated securities fraud action against Andrew Miller, former CEO of Polycom, Inc., alleging that he received about $190,000 in undisclosed perquisites over the course of about three years. The SEC simultaneously announced a settlement with the company itself, assessing a $750,000 penalty – a relatively large sum for a case in which the undisclosed payments were quantitatively immaterial to the company's financial statements. Indeed, the SEC's complaint against the CEO highlighted his efforts to conceal his expenses from the company, and the SEC's administrative order against Polycom recognized the company's prompt remedial actions.

The SEC's colorful complaint against Miller alleges that he regularly incurred lavish personal expenses and obtained reimbursements from the company by submitting falsified expense reports or by directing his administrative assistants to charge the expenses to company purchasing cards; among other things, the SEC alleges that the CEO charged the company for extensive air travel for himself and his girlfriend. The complaint also alleges that the CEO abused a sales incentive program, taking personal vacations that were falsely reported as arising in connection with a program designed to reward top employees.

In the separate settled action against Polycom, the SEC found that the company misstated its executive compensation payments in its annual proxy statements, and kept books and records which failed to accurately reflect its disposition of assets.

The SEC's case against the company turned largely on the contention that Miller was able to conceal his perks because of weaknesses in Polycom's internal accounting controls. For instance, the CEO himself was solely in charge of approving his assistants' purchasing card expenses, and was able to provide his assistants with false descriptions for the items they expensed on his behalf without any oversight. Polycom also allowed Miller to charge flights without describing their purpose.

The SEC's actions confirm that executive compensation cases are particularly appealing for the Division of Enforcement to pursue, situations involving executive perks are the most common target of such cases, and the consequences are serious. Even where the dollars at stake are relatively small, the situations can be presented as extravagant (as can be seen by the Miller complaint) and are unlikely to garner judicial sympathy, making them attractive for SEC litigators. Moreover, because the situations typically implicate qualitative (not quantitative) materiality, the SEC may be inclined to assert fraud when the dollar amounts involved are much lower than in a financial statement reporting context. For this reason, although the total dollar value of the perks that Polycom failed to report was relatively minimal, the SEC pursued a surprisingly aggressive action against both Miller and the company.

Not only is the SEC plainly scrutinizing perks, but the PCAOB is similarly pushing auditors to take a closer look. Last year, the PCAOB revised its audit standards to require auditors to examine executive perks, including "obtain[ing] an understanding of established policies and procedures regarding the authorization and approval of executive officer expense reimbursements."

Given the SEC's aggressive posture on such cases, and the risk of increasing sanctions for companies and their officers, it is essential for corporate boards to ensure that appropriate internal controls are in place to limit the potential for similar abuses. Potential steps to mitigate such risks may include:

> Requiring regular reports to the Audit or Compensation Committee on executive business expenses and reviewing policy standards for when a travel or entertainment event will be treated as business-related or as a perquisite

> Revising expense reimbursement policies to provide separate requirements for the CEO (and potentially other senior officers) so that such officials are not in the position of approving their own expenses, and requiring dual signature authorizations for charges above a certain threshold

> Increasing scrutiny of big-ticket items (such as corporate jets)

> Implementing additional controls around entertainment expenses with large cash outlays, such as employee reward programs

> Updating codes of conduct and internal training programs to emphasize the importance of appropriate expense reimbursement practices

Polycom is just the latest example of the current SEC administration taking an unusually bold stance for a case that might have flown beneath the radar screen in years past. Corporate boards should be assessing their own policies before they find themselves the next company making headlines.

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