PCAOB
Public Company Accounting Oversight Board

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ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS, AND IMPOSING SANCTIONS

In the matter of David C. Lee, CPA,

Respondent.

PCAOB Release No. 105-2016-052

December 20, 2016

By this Order, the Public Company Accounting Oversight Board ("Board" or "PCAOB") is: (1) censuring David C. Lee, CPA ("Lee" or "Respondent"); (2) barring Lee from being associated with a registered public accounting firm;[1] and (3) imposing upon him a civil money penalty in the amount of $10,000. The Board is imposing these sanctions on the basis of its findings that Lee violated PCAOB rules and standards in connection with five audits for one issuer client.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), and PCAOB Rule 5200(a)(1) against the Respondent.

II.

In anticipation of the institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent submitted an Offer of Settlement ("Offer") that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over Respondent and the subject matter of these proceedings, which is admitted,

[1] Lee may petition for Board consent to associate with a registered public accounting firm after two (2) years from the date of this Order.

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Respondent consents to the entry of this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions ("Order") as set forth below.[2]

III.

On the basis of Respondent's Offer, the Board finds[3] that:

A. Respondent

1. David C. Lee, 59, of Issaquah, Washington, is a certified public accountant licensed by the State of Washington (License No. 12242). Lee is a partner in the Seattle office of the registered public accounting firm of Peterson Sullivan LLP ("Peterson Sullivan" or the "Firm") and served as engagement partner on the audits discussed below. At all relevant times, Lee was an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i).

B. Summary

2. This matter concerns Lee's violations of PCAOB rules and standards in connection with the issuance of audit reports on the financial statements of One Horizon Group, Inc. ("OHG" or "Company") for the years ended June 30, 2011 ("2011 Audit") and June 30, 2012 ("June 2012 Audit"); the six months ended December 31, 2012 ("December 2012 Audit"); and the years ended December 31, 2013 ("2013 Audit") and December 31, 2014 ("2014 Audit"). As detailed below, Lee failed to exercise due care and professional skepticism, and failed to obtain sufficient appropriate audit evidence in connection with each of these audits.

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[2] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

[3] The Board finds that Respondent's conduct described in this Order meets the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5), which provides that certain sanctions may be imposed in the event of: (1) intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard; or (2) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

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C. Respondent Violated PCAOB Rules and Standards

Applicable PCAOB Rules and Standards

3. In connection with the preparation or issuance of an audit report, PCAOB rules require that a registered public accounting firm and its associated persons comply with the Board's auditing and related professional practice standards.[4] An auditor may express an unqualified opinion on an issuer's financial statements only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards.[5]

4. Those standards require, among other things, that an auditor plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion,[6] including sufficient appropriate evidential matter to provide reasonable assurance that the issuer's accounting estimates are reasonable, and presented in conformity with applicable accounting principles.[7] Although management representations "are part of the evidential matter the independent auditor obtains, . . . they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit."[8] Moreover, if a management representation "is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made."[9]

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[4] See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*. All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the relevant audit.

[5] See AU § 508.07, *Reports on Audited Financial Statements.*

[6] See Auditing Standard No. 15, *Audit Evidence* ("AS 15") ¶ 4 (in effect for the June 2012 Audit and subsequent audits); see also AU § 326.01, *Evidential Matter* (in effect for the 2011 Audit).

[7] See AU §§ 342.07, .09, .10, *Auditing Accounting Estimates.*

[8] AU § 333.02, *Management Representations.*

[9] Id. at ¶ .04.

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5. For significant risks, PCAOB standards require an auditor to "perform substantive procedures, including tests of details, that are specifically responsive to the assessed risks."[10] PCAOB standards further require that an auditor exercise due professional care and professional skepticism in performing the audit.[11]

6. In the case of significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment, PCAOB standards require the auditor to gain an understanding of the business rationale for such transactions and whether that rationale (or the lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.[12]

7. PCAOB standards require auditors to evaluate whether a company's selection and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and accounting principles used in the relevant industry, and to state in the audit report whether the audited financial statements are presented in accordance with generally accepted accounting principles ("GAAP").[13] PCAOB standards also require auditors to evaluate whether the company's financial statements present fairly its financial position, results of operations, and cash flows in conformity with GAAP.[14]

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[10] Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS 13") ¶ 11 (in effect for the June 2012 Audit and subsequent audits).

[11] See AU § 150, *Generally Accepted Auditing Standards;* AU § 230, *Due Professional Care in the Performance of Work*.

[12] See AU §§ 316.66, .67, *Consideration of Fraud in a Financial Statement Audit.*

[13] See Auditing Standard No. 12 ("AS 12"), *Identifying and Assessing Risks of Material Misstatement* ¶ 12 (in effect for the June 2012 and subsequent audits); AU § 150.02; AU § 411.04, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*.

[14] See Auditing Standard No. 14 ("AS 14"), *Evaluating Audit Results* ¶ 30 (in effect for the June 2012 Audit and subsequent audits); AU § 411.04.

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8. As described below, Lee failed to comply with PCAOB rules and standards in connection with the Firm's 2011 through 2014 audits of OHG.

OHG's 2011 Audit, June 2012 Audit, and December 2012 Audit

9. OHG's predecessor entity, One Horizon Group, PLC ("OHG PLC") was incorporated in England and Wales. OHG PLC observed a June 30 fiscal year, and its 2011 and 2012 financial statements, prepared under the European Union's International Financial Reporting Standards, were subjected to statutory audits performed pursuant to UK law.

10. On November 30, 2012, OHG PLC was nominally acquired in a reverse merger by a U.S. public company with a December 31 fiscal year. Following the merger, the acquiring company changed its name to OHG. At all relevant times, OHG was an "issuer" as that term is defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

11. After the reverse merger, OHG was required to file annual reports, audited in accordance with PCAOB standards, with the U.S. Securities and Exchange Commission ("Commission") for the current period and the two previous years. OHG engaged Peterson Sullivan to audit the current six month period which ended December 31, 2012, as well as the two prior fiscal years, which ended June 30, 2012 and June 30, 2011, respectively. The Firm audited these three periods concurrently (the "2011-12 Audits").

12. Lee, as engagement partner for the 2011-12 Audits, authorized the Firm's issuance of an audit report, dated May 9, 2013, expressing unqualified audit opinions on OHG's financial statements for the years ended June 30, 2011 and June 30, 2012, and the six months ended December 31, 2012. The report was included in OHG's 2012 Form 10-K filed with the Commission on May 13, 2013.

Revenue Recognition: Software Licensing

13. OHG's public filings disclosed that its business involved licensing software and providing related maintenance services to telecommunications companies.[15] OHG's typical software license required payments to be made over a five-year period; however, payment terms varied between customers. OHG required certain customers, known as "Tier One" customers, to make fixed payments on a straight-line basis over

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[15] See OHG 2012 Form 10-K at F-8.

the five-year term. Other customers, which OHG referred to as "Tier Two" customers, were not required to make any license payments until they sold sub-licenses to third party end-users. For the years ended June 30, 2011 and June 30, 2012, and the six months ended December 31, 2012, OHG recognized revenue of $1.425 million, $0, and $3.0 million, respectively, for Tier One customers; and $400,000, $4.6 million, and $3.0 million, respectively, for Tier Two customers.

14. OHG's public filings disclosed its revenue recognition policy related to the Tier One and Tier Two customers. For Tier One customers, OHG recognized revenue at the time of delivery, based on its view of those customers' "commitment to pay, as demonstrated by [their] payment history and [their] ability to pay."[16] For Tier Two customers, OHG recognized revenue pro rata over the collection period, typically over five years.[17] OHG's revenue recognition policy resulted in its recognition of the entire contractual amount immediately upon delivery for its Tier One customers, and on a straight-line basis over the contract's terms for its Tier Two customers (regardless of whether or when those customers sold sub-licenses to end-users, making their payments due).

15. During the 2011-2012 Audits, Lee failed to sufficiently evaluate whether OHG was appropriately recognizing revenue from the Tier One and Tier Two customers under U.S. GAAP.[18] During the audits, Lee apprised management that OHG had a material weakness in its accounting due to management's lack of "sufficient in-house expertise in U.S. GAAP reporting."[19] Lee also planned to prepare a memorandum evaluating the appropriateness of OHG's revenue recognition policy under U.S. GAAP. Despite being aware of OHG's material weakness, Lee failed to

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[16] See id. at F-11.

[17] See id.

[18] Accounting Standard Codification 985, *Software* ("ASC 985") ¶¶ 605-25-34 and 35 state that if "payment of a significant portion of the software licensing fee is not due until . . . more than 12 months after delivery," there is a presumption that revenue should be recognized "as payments from customers become due." This presumption can only be overcome if the company "has a standard business practice of using long-term or installment contracts and a history of successfully collecting under the original payment terms without making concessions." Id., ¶ 605-25-34. In that instance, revenue can be recognized "upon delivery of the software, provided all other conditions for revenue recognition…have been satisfied." Id.

[19] OHG 2012 Form 10-K at 23.

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perform this planned procedure, and failed to prepare any analysis evaluating whether OHG's revenue recognition policy complied with U.S. GAAP.[20]

16. In addition, Lee specifically identified a significant risk of material misstatement regarding the overstatement of Tier Two revenue. In response to this risk, Lee planned to ask OHG for its analysis regarding the relationship between revenue recognition and collection to ensure that it considered potential overstatement. Lee, however, failed to obtain this analysis from OHG management and he failed to perform one.[21] In addition, other than obtaining management's representation regarding the use of a straight-line revenue recognition model for the Tier Two contracts, Lee and the engagement team failed to evaluate whether OHG's use of a straight-line revenue model was appropriate under U.S. GAAP.[22]

17. Furthermore, Lee was aware that OHG's software was a new product that was being sold to new customers. Lee also knew that OHG had no prior experience in licensing this software and did not have a track record to support the straight-line revenue model. At the time OHG filed its 2012 Form 10-K in May 2013, Lee was also aware that OHG had received no payments on accounts receivable balances outstanding at December 31, 2012 for at least six of its Tier Two customers. OHG management also informed Lee that it did not expect payments from certain of these customers due to delays in the sale of sub-licenses. This contradicted the straight-line revenue model's assumption that OHG's Tier Two customers would sell a constant number of sub-licenses and indicated that OHG may have overstated revenue. Despite the fact that this evidence was inconsistent with recognizing revenue on a straight line basis in conformity with U.S. GAAP, Lee failed to perform any procedures to resolve this inconsistency before he authorized the issuance of his audit report.[23]

SatCom Global

18. During the December 2012 Audit, Lee failed to perform sufficient procedures regarding $5 million in revenue, which represented 43% of OHG's reported

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[20] See AS 12 ¶ 12.

[21] See AS No.15, ¶¶ 4-6; see also AU §§ 326.13, .25.

[22] AS No. 14 ¶ 30, AU § 333.02; see also AS No. 15 ¶¶ 4-6; AU §§ 326.13, .25.

[23] AS No. 15 ¶ 29.

revenue for that period, that OHG recognized from an unusual, one-time sale of billing software.

19. OHG sold its legacy satellite equipment business, SatCom Global ("SatCom") on October 25, 2012.[24] On that same day, in a non-cash transaction, OHG transferred all rights in the billing software SatCom used to SatCom's purchaser for $5 million.[25] The entire $5 million purchase price for the billing software was paid by means of an "offset" [26] against amounts OHG owed to SatCom.[27]

20. Because OHG accounted for the sale of the SatCom billing software as a separate transaction from its sale of the SatCom business, instead of including the software sale in the calculation of its "gain or loss on sale" of the SatCom business, OHG consequently reported the entire $5 million as revenue.

21. Even though the sale of the SatCom billing software was an unusual, one-time, non-cash transaction that occurred on the same day as and between the same parties to the sale of the SatCom business, and represented over 40% of OHG's reported revenue, Lee failed to gain a sufficient understanding of the business rationale for this transaction or to consider whether OHG management was placing more emphasis on the accounting treatment of that $5 million sale than on its underlying economics, as required under PCAOB standards.[28] In addition, Lee failed to perform any procedures to evaluate whether the accounting for the transaction complied with U.S. GAAP.[29] Lee also failed to perform any procedures to determine whether the billing software was properly valued.[30]

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[24] See OHG 2012 Form 10-K at 8.

[25] See id. at F-10.

[26] Id.

[27] The amount due from OHG to SatCom purportedly arose from an inter-company payable that, prior to the sale of SatCom, had been owed by an OHG subsidiary to SatCom.

[28] See AU §§ 316.66, .67.

[29] AS No. 14 ¶ 30.

[30] AS No.15 ¶¶ 4-6.

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OHG's 2013 Audit

22. Lee, as engagement partner, authorized the Firm's issuance of an audit report, dated April 15, 2014, expressing an unqualified audit opinion on OHG's financial statements for the year ended December 31, 2013, the restated six months ended December 31, 2012 and the restated year ended June 30, 2012. The report was included in OHG's 2013 Form 10-K filed with the Commission on April 15, 2014.

23. Prior to the Firm's issuance of an audit report for the 2013 Audit, OHG management provided Lee and his engagement team with a schedule during each of the 2013 quarterly reviews that showed the total lifetime cumulative revenue OHG had recognized for each Tier Two customer and the actual payments it had received on those contracts ("Revenue Schedules").

24. The Revenue Schedules showed a large and increasing gap between the amount of revenue OHG recognized on its Tier Two customer contracts and the amount it had actually collected. For example, the first quarter Revenue Schedule showed that OHG had recognized $9.9 million in cumulative revenue for its Tier Two customers, even though it had only collected about $1.3 million from those customers, a difference of more than $8 million between revenue recognized and revenue collected. This gap increased to more than $10 million and $16 million by the end of the second and third quarters, respectively. Lee was aware of the increasing amount of uncollected revenue that OHG had recognized due to its use of the straight-line revenue recognition model for its Tier Two contracts. Indeed, the engagement completion document for the third quarter review states that Lee communicated to OHG management and its board of directors that revenue recognition was ahead of cash collections, and notes that "[t]he company will update their revenue recognition policy prior to the annual audit."

25. On April 8, 2014, OHG filed a Form 8-K with the SEC announcing that the company would restate its previously-issued financial statements[31] "to correctly record the timing of revenue recognition for certain license fees."[32] OHG stated that the

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[31] OHG Form 8-K (April 8, 2014). The restatements, filed on April 15, 2014 in OHG's 2013 Form 10-K, reduced OHG's previously reported revenue by approximately $1.825 million, $2.61 million, and $4.75 million for the years ended June 30, 2011 and June 30, 2012, and the six months ended December 31, 2012, respectively, representing revenue overstatements of approximately 203 percent, 100 percent, and 68 percent for those periods.

[32] Id.

original use of a straight-line revenue recognition model for its Tier Two customers "was not expected to vary materially from the customer usage."[33] After evaluating customer activity, however, OHG determined that the "straight-line method was not appropriate" and would instead recognize revenue on those contracts when payments became due.[34] OHG also stated that it had "re-evaluated" its revenue recognition policy for Tier One customers, and concluded that it would recognize revenue for these customers "to the extent that fixed payments become due," instead of at the time of delivery.[35]

26. As of December 31, 2013, however, OHG continued to have approximately $7.5 million in gross accounts receivable, for which it established a bad debt allowance of $212,000, or approximately 3% of its total accounts receivable.

27. Lee failed to perform sufficient procedures regarding the accounts receivable and bad debt allowance during the 2013 audit. During the audit, Lee was aware that OHG had recognized large amounts of uncollected revenue from Tier Two customers, for which it had restated its prior period financial statements. Lee was also aware at the time of the audit that receivables from Tier Two customers comprised approximately 79% of the total accounts receivable balance and that, as of April 2014, only one payment from a Tier Two customer of $125,000 had been received. Other than obtaining management representations that the Company "will be more aggressive in collections" once its customers had completed implementing the software, Lee failed to gain an understanding of how OHG management determined its bad debt allowance or to evaluate the reasonableness of the allowance.[36] Further, Lee failed to perform a retrospective review of OHG's bad debt allowance, or the Company's historical experience in collecting its accounts receivable.[37]

OHG's 2014 Audit

28. Lee, as engagement partner, authorized the Firm's issuance of an audit report, dated March 31, 2015, expressing an unqualified audit opinion on OHG's

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[33] Id.

[34] Id.

[35] Id.

[36] See AU §§ 342.07, .10.

[37] See AU §§ 316.64, 342.09.

financial statements for the year ended December 31, 2014. The report was included in OHG's 2014 Form 10-K filed with the Commission on April 1, 2015.

29. OHG disclosed in its 2014 Form 10-K that effective October 1, 2014, it had amended certain customer contracts whereby all "future payments will be due from the customer when that customer has generated revenue from its customers who subscribe to use the Horizon products and services." OHG further stated that for customers with outstanding balances under the prior agreements, payments received after September 30, 2014 would not be recognized as revenue under these "Revenue Sharing" agreements, but instead would be applied to the customer's existing accounts receivable balances first.

30. As of December 31, 2014, OHG reported gross accounts receivable of approximately $9.6 million, offset by an allowance of $492,000, or about 5% of the accounts receivable balance. The majority of the receivable balance consisted of balances that were aged greater than one year as of December 31, 2014, and were due from customers now under the new Revenue Sharing arrangements.

31. Lee failed to perform sufficient procedures regarding the accounts receivable balance and bad debt allowance. At the time of the audit, Lee was aware that payments had not been made on the Revenue Sharing accounts in late March 2015, almost six months after the Revenue Sharing agreements became effective. Despite being aware of this fact, Lee relied on management's representation that its customers would generate sufficient future revenue under the new Revenue Sharing agreements to pay all outstanding balances. Other than obtaining that representation, which alone was insufficient audit evidence, Lee failed to perform any procedures to evaluate the reasonableness of OHG's bad debt allowance.[38]

32. Approximately one year later, OHG reported in its 2015 Form 10-K, filed with the Commission on March 31, 2016, that as of December 31, 2015, a significant portion of the Revenue Sharing customer's receivables remained uncollected. OHG increased its bad debt allowance by approximately $5.6 million (i.e., more than half of the 2014 year-end accounts receivable balance) with a corresponding charge to bad debt expense.[39] This charge constituted approximately 50% of the net loss reported by OHG for the year ended December 31, 2015.

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[38] See AU §§ 316.64, 342.07, .09.

[39] Approximately five months later, OHG reported in a Form 10-Q filed with the Commission on August 9, 2016 that these balances had been fully written off.

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IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Lee's Offer. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), David C. Lee is hereby censured;

B. Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), David C. Lee is barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i);[40]

C. After two (2) years from the date of this Order, David C. Lee may file a petition, pursuant to PCAOB Rule 5302(b), for Board consent to associate with a registered public accounting firm; and

D. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $10,000 payable by David C. Lee is imposed. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. David C. Lee shall pay this civil money penalty within 10 days of the issuance of this Order by (a) wire transfer in accordance with instructions furnished by Board staff; or (b) United States postal money order, certified check, bank cashier's check or bank money order; (c) made payable to the Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006; and (3) submitted under a cover letter which identifies David C. Lee as the Respondent in these proceedings, and states that payment is made pursuant to this Order, a

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[40] As a consequence of the bar, the provisions of Section 105(c)(7)(B) of the Act will apply with respect to Lee. Section 105(c)(7)(B) provides: "It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any issuer, broker, or dealer in an accountancy or a financial management capacity, and for any issuer, broker, or dealer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission."

copy of which cover letter and money order or check shall be sent to the Office of the Secretary, Attention: Phoebe Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

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Phoebe W. Brown
Secretary

December 20, 2016