

COMMENTS ABOUT SEC V. THOR INDUSTRIES: THE ALLEGATIONS AND THE REMEDIES

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The SEC's recent action against Thor Industries can be found at:

<http://www.sec.gov/litigation/litreleases/2011/lr21966.htm> and

<http://www.sec.gov/litigation/complaints/2011/comp21966.pdf>.

In pertinent part, pursuant to the allegations in the litigation release (which is copied and pasted below) and in the Complaint, Thor and its subsidiaries lacked reporting, recording keeping and internal controls, including the failure to segregate duties, which allegedly permitted an officer to perpetuate fraud. At the time, Thor was also subject to a prior 1999 cease and desist order that prohibited violations of the book, records and internal control requirement. In other words, in 1999 Thor represented that it would fix the internal control deficiencies and that they would not occur again. The alleged improprieties in the current situation appear to have been material to Thor but qualitatively and quantitatively.

As stated in the litigation release, to settle the current action “the SEC and Thor agreed as follows: “Without admitting or denying the allegations in the complaint, Thor has consented to the entry of a final judgment: (1) requiring it to comply with the 1999 cease-and-desist Order; (2) permanently enjoining it from violating Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder; (3) ordering it to pay a \$1 million penalty pursuant to Exchange Act Section 21(d)(3) for violating the 1999 Order; and (4) ordering it to hire an independent consultant to review and evaluate certain of its internal controls and record-keeping policies and procedures.”

It needs to be acknowledged that the allegations against Thor are just that, allegations. Nevertheless, the allegations in the SEC's Complaint, as far as they go, are fairly detailed. It appears that Thor and its various subsidiaries were significantly run as separate operations. The subsidiaries lacked sufficient internal controls, as did Thor itself and to oversee the subsidiaries.

Thor's stock is traded on the New York Stock Exchange.

As I view the action and the remedy, Thor paid a fairly hefty penalty to have the SEC agree for a second time that the company needs to get its internal controls and record keeping in order, which appears to be a pretty good outcome for Thor. Not much different than after the 1999 Order.

Here are at least some of the unresolved issues. But I am sure that many of my governance, risk, internal audit, and compliance friends could come up with additional issues and suggested remedies. The SEC does not discuss the actions or inactions of many of the people who were

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involved or arguably should have been involved in or aware of the circumstances that occurred. I am not saying that these other people were culpable or liable, or even that the SEC should have brought an action against them—just that the SEC should have discussed the facts of what allegedly occurred in greater detail, and then at least adjusted the non-monetary remedy accordingly. Thor is required to have an internal audit function. Its financials are audited annually, and reviewed quarterly by its outside auditor. Thor's board assesses and manages risks, pursuant to Thor's website. And, of course, Thor has executive officers, a board, and an audit committee. Thor's website contains the usual corporate, governance, ethics policy, and board information and representations. I just find the current remedies to be significantly deficient and lacking in detail. One clearly needs to ask how all of this managed to happen, and who did what and did not do what, and then design and implement actual changes from top to bottom seriously and reasonably calculated to prevent a third reoccurrence and restore faith. Where were internal audit and the outside auditor? Where were the board and the audit committee? Where were the relevant executive officers, the CEO? Was there any anonymous reporting? Wasn't a concerted corrective effort made after the 1999 Order? Is there a compliance and ethics officer or function? As stated, the SEC's allegations are just that, allegations, and I am sure that Thor would have presented credible and perhaps even winning defense arguments if the case had proceeded onward; however, in settlement a case like this presents an opportunity for the company and for the SEC to remedy the current situation and to provide guidance to people at other listed companies.

The following is the copy and paste of the SEC's litigation release:

SEC Charges Thor Industries With Violating Commission Cease-and-Desist Order and Charges Former VP of Finance of Thor Subsidiary With Securities Fraud

The Securities and Exchange Commission filed a settled enforcement action in United States District Court for the District of Columbia charging Ohio-based producer of recreational vehicles Thor Industries, Inc. with issuer reporting, record-keeping, and internal control violations. Thor has agreed to be permanently enjoined and to pay a \$1 million civil penalty for violating a 1999 Commission cease-and-desist Order prohibiting violations of the books and records and internal controls provisions. *In the Matter of Thor Industries, Inc.*, Exchange Act Release No. 42021 (Oct. 18, 1999). The SEC also charged Mark C. Schwartzhoff, a former Vice President of Finance at Thor's Dutchmen Manufacturing, Inc. subsidiary, with securities fraud and other violations. Schwartzhoff has agreed to be permanently enjoined, to be permanently barred from serving as an officer or director of a public company, and to be permanently suspended from appearing or practicing before the Commission as an accountant. Schwartzhoff also agreed to pay disgorgement of \$394,830, which shall be deemed satisfied by the entry of a restitution order against Schwartzhoff in a parallel criminal case.

The SEC's complaint alleges that from approximately December 2002 to January 2007, while serving as the senior financial officer of Dutchmen, one of Thor's principal operating subsidiaries, Schwartzhoff engaged in a fraudulent accounting scheme to understate Dutchmen's cost of goods sold in order to avoid recognizing inventory costs that were not reflected in Dutchmen's financial accounting system. Instead of properly recording increased cost of goods

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sold, Schwartzhoff concealed the costs in various balance sheet accounts by making baseless manual journal entries to falsify the financial statements and other records he provided to Thor. To cover-up his false entries, the complaint alleges that Schwartzhoff created false supporting documentation and false account reconciliations. Schwartzhoff also submitted false documents and information to Thor's external auditor.

As alleged in the complaint, Schwartzhoff's fraud overstated Dutchmen's pre-tax income by nearly \$27 million from fiscal year 2003 to the second quarter of fiscal 2007, and allowed him to obtain nearly \$300,000 in ill-gotten bonuses. In June 2007, Thor filed restated financial statements for fiscal years 2004 to 2006, each of the quarters of fiscal 2005 and 2006, and the first quarter of fiscal 2007, reducing its pre-tax income by approximately \$26 million in the aggregate.

The SEC's complaint further alleges that Thor failed to maintain accurate books and records and adequate internal accounting controls in violation of a 1999 Commission cease-and-desist Order. The Order directed Thor to cease and desist from committing future books and records and internal controls violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), based on similar misconduct and internal control deficiencies that occurred over four years at a different Thor subsidiary.

The complaint alleges that Thor's failure to implement adequate internal controls after the 1999 Order provided Schwartzhoff the opportunity to commit his fraud without detection. In particular, Thor failed to adequately implement and verify certain key segregation of duties within accounting and financial functions at Dutchmen, which allowed Schwartzhoff to have unfettered access rights to Dutchmen's accounting system, the ability to create, enter and approve manual journal entries, and the ability to create and approve account reconciliations. As a result, Schwartzhoff was able to make fraudulent journal entries in various accounts and to disguise these entries through account reconciliations and supporting documents that he falsified. In addition, as alleged in the complaint, Thor failed adequately to monitor and verify account reconciliations and account information that Schwartzhoff submitted in reporting Dutchmen's financial results. Thor also failed to implement an effective internal audit function for Dutchmen.

As the SEC's complaint alleges, after Schwartzhoff's fraud came to light, Thor concluded that the internal control failures at Dutchmen constituted a material weakness in Thor's internal controls over financial reporting. Thor also determined that similar lack of segregation of duties existed in varying degrees at each of its subsidiaries. For example, senior accounting officers (Controllers and Vice Presidents of Finance) at numerous subsidiaries had the ability to create, enter, and approve journal entries and reconciliations in accounts such as accounts receivable, accounts payable, and cash. At all but one subsidiary, various individuals had inappropriate access rights to accounting and information systems, including "super user" access by senior accounting officers at some subsidiaries. In addition, the complaint alleges Thor also determined that it lacked sufficient corporate level monitoring of account reconciliations for all of its subsidiaries.

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Without admitting or denying the allegations in the complaint, Thor has consented to the entry of a final judgment: (1) requiring it to comply with the 1999 cease-and-desist Order; (2) permanently enjoining it from violating Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder; (3) ordering it to pay a \$1 million penalty pursuant to Exchange Act Section 21(d)(3) for violating the 1999 Order; and (4) ordering it to hire an independent consultant to review and evaluate certain of its internal controls and record-keeping policies and procedures.

Without admitting or denying the allegations in the complaint, Schwartzhoff has consented to the entry of a final judgment: (1) permanently enjoining him from violating Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) and Rules 12b-20, 13a-1 and 13a-13 thereunder; (2) ordering him to pay disgorgement of \$299,805 plus prejudgment interest of \$95,025, for a total of \$394,830, with payment of this amount to be deemed satisfied by the entry of a restitution order against Schwartzhoff in a parallel criminal case that is equal to or greater than \$394,830; and (3) permanently barring him from serving as an officer or director. Schwartzhoff also consented to the issuance of an order pursuant to Rule 102(e) of the Commission's Rules of Practice, permanently suspending him from appearing or practicing before the Commission as an accountant.

These settlements are subject to the approval of the United States District Court for the District of Columbia. The settlement with Thor takes into account the company's self-reporting and significant cooperation in the SEC's investigation.

Separately, on May 12, 2011, the United States Attorney's Office for the Northern District of Indiana filed a related criminal action against Schwartzhoff, and Schwartzhoff agreed to plead guilty to an Information charging him with one count of wire fraud and to pay restitution of approximately \$1.9 million.

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