

**U.S. Securities and Exchange Commission****UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION****SECURITIES ACT OF 1933
Release No. 7994 / July 18, 2001****SECURITIES EXCHANGE ACT OF 1934
Release No. 44563 / July 18, 2001****ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 1422 / July 18, 2001****ADMINISTRATIVE PROCEEDING
File No. 3-10532**

In the Matter of

American Bank Note Holographics,
Inc

Respondent.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 8A OF
THE SECURITIES ACT OF 1933
AND
SECTION 21C OF THE
SECURITIES
EXCHANGE ACT OF 1934,
MAKING
FINDINGS, AND IMPOSING A
CEASE-
AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to institute public administrative proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against American Bank Note Holographics, Inc. ("Respondent" or "ABNH").

II.

In anticipation of the institution of these administrative proceedings, Respondent has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings, except as to the Commission's jurisdiction over it and over the subject matter of the proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order").

III.

On the basis of this Order and Respondent's Offer, the Commission makes the findings set forth below.¹

A. Respondent

American Bank Note Holographics, Inc. is a Delaware corporation with its principal executive offices located in Elmsford, New York. ABNH is engaged in the origination, production, and marketing of mass-produced secure holograms. Until July 1998, ABNH was a wholly-owned subsidiary of American Banknote Corporation ("ABN"). ABN, at the time, was a publicly traded holding company that through its subsidiaries, among other things, supplied stored-value telephone cards and magnetic-strip transaction cards and printed business forms, checks, and counterfeit-resistant documents of value such as money orders, passports, foreign currency, and stock and bond certificates.²

On or about July 15, 1998, ABNH became a public company through an initial public offering ("IPO") that raised approximately \$107 million (pricing shares at \$8 ½ per share), the proceeds of which went entirely to ABN.³ ABNH's stock was registered pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange ("NYSE") until August 1999, when ABNH's stock was suspended from trading. ABNH's common stock currently trades on the OTC Bulletin Board. During the relevant period, ABNH's fiscal year ended on December 31.

B. Summary

Prior to July 1998, ABNH was a wholly-owned subsidiary of ABN. In July 1998, ABNH went public in an IPO in which its parent, ABN, sold its entire interest in ABNH to the public. The ABNH offering raised approximately \$107 million, which ABN used to reduce its debt.

The ABNH public offering took place pursuant to a Registration Statement filed on

Form S-1 with the Commission. That document contained financial statements for ABNH for its fiscal years ended December 31, 1996 and December 31, 1997. Also included were quarterly financial results for fiscal year 1997 and for the first quarter of fiscal year 1998. After the IPO, ABNH went on to file quarterly financial statements for its second and third quarters in fiscal year 1998.

Every one of the financial statements set forth above was fraudulent. Each one reflected a fraudulent course of conduct. Initially, the purpose of the fraud was to make it appear that ABN was meeting earnings forecasts. Thereafter, the fraud continued in order to condition the market for ABN to sell, or to commence an IPO for, ABNH, so that ABN could pay down its debts and then, solely as to ABNH, to exaggerate its success and profitability.

ABN and ABNH, through the actions of their former senior managers and others, engaged in a variety of improper practices that materially increased annual and quarterly revenue and net income in departure from generally accepted accounting principles ("GAAP"). In addition,

the two companies sought to cover-up their wrongdoing by falsifying documents and by lying to ABN's independent auditors. In summary, ABNH engaged in the following improper practices:

- recognizing revenue upon the shipment of holograms when ABNH knew the customer would only pay for the product based upon usage (i.e., improper recording of consignment sales);
- recognizing revenue on "bill and hold" sales of holograms that did not meet the criteria for valid "bill and hold" sales;
- recognizing revenue on shipments of work in process;
- recognizing revenue with respect to holograms that were never shipped;
- recognizing revenue for holograms shipped to customers, which the customers had not purchased;
- recognizing revenue for holograms shipped to third-party warehouses which the customers had not purchased;
- recognizing revenue on an alleged sale of holograms that was conditioned upon the customer obtaining a renewal of a government contract, which the customer failed to obtain;
- recognizing revenue in connection with a government contract before completing work under the contract;
- holding open quarters in order to record additional hologram related revenue;
- recognizing revenue in connection with hologram related work at a time when the customer's obligation to pay was subject to a contingency that had not been satisfied;
- falsifying documents to mislead its outside auditors as to the validity of a "bill and hold" sale;
- maintaining, and not sharing with the auditors, a separate set of records to track customers' payment obligations for consignment sales;
- inducing customers to provide false audit confirmations; and
- signing a false and misleading management representation letter to its outside auditors.

As a result of the foregoing improper acts, ABNH filed with the Commission a Registration Statement on Form S-1 in July 1998 that contained materially false and misleading financial statements and other information pertaining to ABNH for fiscal years 1996, 1997, and the first quarter of fiscal year 1998, as well as the unaudited quarterly operating results for fiscal year 1997 and the first quarter of fiscal year 1998. ABNH also filed with the Commission materially false and misleading financial statements on Form 10-Q for the second and third quarters of fiscal year 1998. Moreover, as a result of this conduct, ABNH's books, records, and accounts were falsified and consequently ABNH failed to make and keep books, records, and accounts that accurately and fairly reflected ABNH's transactions and dispositions of assets. Furthermore, ABNH failed to devise and maintain a system of

internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with GAAP.

On Tuesday, January 19, 1999, ABNH announced that it would restate results for the second and third quarters of 1998 and that it expected that revenues and net income for the fourth quarter of 1998 would be significantly lower than that of the fourth quarter of 1997. ABNH's stock fell from its January 19, 1999 close of \$15.125 to a January 20, 1999 close of \$4.625, losing 69.4% of its value in a single day's trading. ABN's stock fell from its January 19, 1999 close of \$1 5/16 to a January 20, 1999 close of \$1 1/8, losing 14.3% of its value during that trading day. On Monday, January 25, 1999, ABNH announced that it would restate its results for each of the first three quarters of 1998 and that its financial statements as of December 31, 1997, and December 31, 1996, and the related Report of Independent Auditors, should no longer be relied upon. Following a day of suspension from trading on January 25, ABNH closed at \$1 13/16, more than 50% lower than the previous trading day's close. ABN's stock, also suspended for a day, then closed at \$15/16, approximately 12% lower than the previous trading day's close.

After initiating an internal investigation in January 1999, ABNH made its findings available to the Commission staff, continued to cooperate with the Commission staff's investigation of this matter, and replaced its former senior management with a new management team each member of which arrived after the wrongdoing described below. In December 1999, following its internal investigation, ABNH restated its annual financial statements for fiscal years 1996 and 1997, its quarterly financial statements for fiscal year 1997, and its quarterly financial statements for the first three quarters of fiscal year 1998.

The restatements had a material effect on ABNH's previously reported annual revenue and net income:

	Net Revenue (thousands)			Net Income (thousands)		
	Originally Reported	As Restated	% Overstated	Originally Reported	As Restated	% Overstated
1997	\$30,915	\$23,085	+34%	\$7,539	\$2,820	+167%
1996	\$28,649	\$27,516	+4%	\$4,820	\$4,338	+11%

The restatements also materially affected ABNH's previously reported quarterly revenue and net income for fiscal year 1997 and the first three quarters of fiscal year 1998:

	Net Revenue (thousands)			Net Income (thousands)		
	Originally Reported	As Restated	% Misstated	Originally Reported	As Restated	% Misstated
Q1'97	\$5,241	\$6,198	-15%	\$657	\$633	+3.8%
Q2'97	\$6,296	\$5,969	+5%	\$1,422	\$909	+56%
Q3'97	\$8,104	\$7,786	+4%	\$2,275	\$2,245	+1.34%
Q4'97	\$11,274	\$3,132	+260%	\$3,185	\$ (967)	+429%
Q1'98	\$7,035	\$10,176	-31%	\$1,793	\$2,510	-29%

Q2'98	\$9,581	\$4, 636	+107%	\$2,279	\$387	+489%
Q3'98	\$10,524	\$5,091	+107%	\$2,771	\$294	+843%

In addition to the financial statement fraud described above, ABNH also violated the anti-bribery provisions of the Foreign Corrupt Practices Act, Section 30A of the Exchange Act, when it wired \$239,000 to a foreign bank account for the benefit of one or more foreign government officials.

A. Facts

1. ABNH Improperly Recognized Revenue on Consignment and "Bill and Hold" Sales, and for Research and Development Work in 1996

a) Improper Recognition of Revenue on Consignment Sales

At the end of the third quarter of fiscal year 1996, ABNH improperly recognized revenue of \$407,000 on a consignment sale to one of its customers. In the fourth quarter of fiscal year 1996, ABNH improperly recognized revenue of approximately \$238,000 on another consignment sale to a different customer. In each instance, ABNH shipped a large number of holograms to the customer and agreed to bill them on a monthly basis based upon the number of holograms the customer used during the month. Despite the fact that the customers had only agreed to purchase the holograms they actually used, ABNH recognized revenue on the entire shipment of holograms to each customer. Because the risks and rewards of ownership for the unused holograms had not yet passed to the customers, recognizing revenue for all the holograms upon shipment did not conform to GAAP and had the effect of improperly inflating revenue and net income.

b) Improper Recognition of Revenue for "Bill and Hold" Sales

During the time that ABNH was a wholly-owned subsidiary of ABN, ABNH's operations contributed materially to ABN's net income. To monitor ABNH's financial performance, ABN assisted ABNH in creating annual budgets that projected ABNH's revenue and earnings for a particular fiscal year. Thereafter, ABN reviewed financial forecasts ABNH prepared on a semi-monthly basis to determine whether ABNH would meet its projected revenue and net income for that quarter.

In mid to late January 1997, it became apparent to ABN and ABNH that ABNH had failed to meet its fourth quarter budget and forecasts for revenue. This shortfall would have materially impacted ABN's fiscal year 1996 net income and negatively impacted ABN's efforts to meet earnings forecasts. Consequently, on or about January 30, 1997, well after ABNH had closed its books for fiscal year 1996, ABNH improperly accrued revenue for two "bill and hold" sales.⁴

Accruing the revenue in fiscal year 1996 for the two "bill and hold" transactions, one in the amount of \$231,000 and the other in the amount of \$404,250, was improper. ABNH and the customers had not entered into these sales on or before December 31, 1996 and the two transactions did not meet the criteria for recognizing revenue for "bill and hold" sales under AAER Number 108.⁵ Also, the \$404,250 transaction, which was with the same customer with whom ABNH had entered into the third quarter improperly recorded consignment sale,

did not occur. No purchase order, invoice, or shipping documents were ever generated and ABNH subsequently reversed the sale in the first quarter of fiscal year 1997.

c) Improper Recognition of Revenue for Research and Development Work

In addition to accruing revenue for two improper "bill and hold" sales, ABNH further inflated its fourth quarter revenue and net income by accruing revenue of \$800,000 for research and development work it had performed for a foreign customer.

On or about January 30, 1997, ABNH accrued revenue of \$800,000 for fiscal year 1996, which purportedly reflected research and development work ABNH had done for that customer. However, as of December 31, 1996, ABNH had neither billed its customer for this amount nor received payment of this amount. More importantly, however, ABNH's accrual of revenue to offset these costs was improper because ABNH's customer, to the extent it had any obligation to pay this sum, did not have an unconditional obligation to pay ABNH \$800,000 as of December 31, 1996. Payment of the \$800,000 obligation was contingent, at a minimum, upon certain approvals being obtained from government officials. This had not occurred as of December 31, 1996 and, in fact, the government officials never gave the required approvals.

d) ABNH Provided ABN's Auditors with False Confirmations of the "Bill and Hold" and Research and Development Transactions

In the course of auditing ABN, ABN's auditors generally deployed a separate team of auditors to ABNH to audit its books. Certain members of the ABNH audit team would then participate in the ABN corporate audit. To convince ABN's outside auditors that its two December 29, 1996 "bill and hold" sales were proper, ABNH obtained from the two customers signed audit confirmations that falsely attested that the transactions had been entered into as of December 29, 1996, and that the transactions met certain of the criteria set forth in AAER 108. ABNH also was able to secure an audit confirmation letter from the customer for whom it had performed research and development work. In that confirmation, the customer acknowledged that it owed ABNH \$800,000 for research and development work as of December 29, 1996. The customer, however, did not disclose that its obligation to pay the \$800,000 was subject to contingencies that had not yet been satisfied.

2. ABNH Improperly Increased 1997 Revenue and Net Income In Anticipation of a Sale of ABNH

a) Improper Recognition of Revenue on Consignment Sales During the First Three Quarters of 1997

ABNH continued to improperly increase its reported revenue and net income in fiscal year 1997 by, among other things, again improperly recognizing revenue on consignment sales. During the first three quarters of 1997, ABNH improperly recognized revenue of over \$900,000 for consignment sales.

To keep track of its customers' payment obligations under consignment sales, ABNH used a separate set of records that it did not share with

ABN's auditors. Upon receiving usage reports from its customers, ABNH issued invoices to bill them for that usage. Unlike the invoices issued at the time of the initial "sale" of the holograms, which were not sent to the customers, these invoices reflected actual obligations of the customers. ABNH tracked the "usage" invoices in ledgers that were kept by hand.

b) ABNH Improperly Recognized Over \$4 Million in Net Income in the Fourth Quarter of 1997 to Position Itself for a Sale or an IPO

As fiscal year-end 1997 approached, ABN, which was highly leveraged at the time, considered various approaches to reduce the company's debt, including a possible sale of ABNH. In order to condition the market for this possible sale, as well as to meet earnings forecasts, ABNH massively inflated its fourth quarter revenue by approximately \$8,000,000 or 260%, and its fourth quarter net income by approximately \$4,000,000 or 429%. In order to accomplish this, ABNH improperly recognized revenue on a number of transactions in the fourth quarter, including additional consignment sales, shipments of unusable work in process, and an improper "bill and hold" sale.

(1) ABNH Shipped Work in Process and Improperly Recognized Revenue on Additional Consignment Sales

In the fourth quarter of fiscal year 1997, ABNH shipped unusable work in process to a customer on New Year's Eve. ABNH boxed up the work in process and then hired a truck to deliver the boxes to the customer. ABNH recorded revenue of approximately \$1.3 million on this shipment notwithstanding the fact that, as ABNH knew, the goods would be returned shortly after being shipped. Also, in the fourth quarter of fiscal year 1997, ABNH recognized revenue of \$949,000 on improperly recorded consignment sales. These improperly recorded consignment sales involved the same three customers who entered into improperly recorded consignment sales with ABNH in the first three quarters of fiscal year 1997, as well as one additional customer.

(2) Improper Recognition of Approximately \$6 Million in Revenue on an \$8 Million "Bill and Hold" Order

ABNH recognized revenue of approximately \$6.9 million in fiscal year 1997 on a "bill and hold" sale to one of its largest customers, approximately \$6 million of which was improper because it should have been recognized in fiscal year 1998. This was by far the largest improperly booked transaction by ABNH in fiscal year 1997. Although ABNH had a valid "bill and hold" agreement in place with the customer, the transaction was improper because ABNH recognized revenue from the sale of holograms that had not actually been completed by December 31, 1997.

Late in the fourth quarter, ABNH's customer placed a "bill and hold" order for approximately \$8 million worth of holograms. ABNH understood that to recognize revenue on the entire sale in fiscal year 1997, all of the holograms would have to be completed, meaning that ABNH had to have at its facility by fiscal year-end 1997 "reels"⁶ of numbered holograms labeled as belonging to the customer.⁷ ABNH, however, lacked the capacity to manufacture such a large quantity of holograms by year-end. In an effort to manufacture and complete as

many of the holograms as soon as possible, ABNH subcontracted the manufacturing of approximately \$6.9 million worth of holograms to another company (the "Subcontractor").

ABNH, however, knew that the Subcontractor could not manufacture and complete all the holograms by year-end. The Subcontractor did not have the capacity to manufacture all the holograms by year-end. Indeed, ABNH's agreement with the Subcontractor called for a production schedule that continued into mid-January 1998. Further, before ABNH could treat the sale of these holograms as a valid "bill and hold" sale, the holograms had to be "completed." This required the holograms, which are initially produced in "rolls," (e.g., like a roll of paper towels), to be slit down to smaller "reels" (like a roll of paper towels cut into thirds, for example) and then numbered and separately labeled as belonging to the customer. ABNH knew that the Subcontractor was engaged only to manufacture rolls because the Subcontractor's facility lacked the capacity to slit the rolls into reels and then number the holograms. Consequently, ABNH knew that the holograms the Subcontractor produced would not be "complete" until they were delivered to ABNH's facility and ABNH then slit, numbered, and labeled them as belonging to the customer.

As expected, the Subcontractor did not finish producing unslit, unnumbered rolls of holograms until mid-January 1998. Not only did ABNH know that production had continued into January, it also knew that most of the rolls the Subcontractor produced were delivered to ABNH's manufacturing facility in January 1998. Moreover, ABNH also knew that virtually all of the rolls the Subcontractor produced were slit and numbered at ABNH's facility in early 1998. Nevertheless, ABNH, in December 1997, recognized revenue for all of the holograms the Subcontractor manufactured.

c) ABNH Misled ABN's Auditors To Hide Fiscal Year 1997 Fraudulent Sales

ABN's auditors identified the \$8 million "bill and hold" transaction as a major issue for its audit of ABNH's results for fiscal year 1997. As a result, ABNH undertook to mislead ABN's auditors into believing that the holograms the Subcontractor produced were completed and had been delivered to ABNH's facility by fiscal year-end 1997. On numerous occasions, ABNH told ABN's auditors that all of the Subcontractor's holograms had been completed and received at ABNH's facility by fiscal year-end 1997. In addition, ABNH backdated, and changed quantities on, ABNH receiving documents, which were provided to the auditors to convince them that ABNH had received all of the Subcontractor's holograms by December 31, 1997. ABNH then changed copies of the Subcontractor's delivery receipts, altering dates and quantities to make them consistent with the inaccurate receiving documents, and fabricated "vault receipts," which purported to show that the hologram "rolls" ABNH had received had been slit into numbered reels. ABNH provided these documents to ABN's auditors as well.

Also, ABNH obtained a false written confirmation from the security firm hired to provide security at the Subcontractor's facility to the effect that personnel from the security firm had witnessed ABNH pick up "reels" of holograms from the Subcontractor and that all the pickups were completed by December 31, 1997. At ABNH's request, the

security firm sent this confirmation to ABNH's auditors.

Finally, ABNH obtained from the Subcontractor a false confirmation to ABN's auditors that falsely confirmed that the Subcontractor had manufactured "reels" of numbered holograms and that all of the holograms required under the terms of the purchase order had been manufactured, and picked up by ABNH, by December 31, 1997.

In addition to the false and misleading oral and written statements made in connection with confirming the 1997 fiscal year-end "bill and hold" transaction, ABNH also obtained two additional false audit confirmations that it provided to ABN's auditors in an effort to conceal other improperly booked fiscal year 1997 sales. In one instance, ABNH induced the customer to which it had shipped the unusable work in process discussed above, to confirm an accounts receivable balance as of fiscal year-end 1997 that included the alleged sale of the unusable work in process the customer had returned to ABNH in early January 1998. Also, in at least one instance involving improperly recognized revenue on a consignment sale, ABNH was able to persuade one of its customers to provide a confirmation to its auditors that misleadingly confirmed an incorrect balance receivable as of December 31, 1997. In fact, a substantial portion of the confirmed balance receivable constituted the sales value of a large quantity of holograms that had been provided to that customer under a consignment arrangement pursuant to which the customer was only obligated to pay for those holograms it used. ABNH also did not disclose to the auditors the "usage" invoices it sent to customers that had taken holograms on consignment, nor did it disclose the ledgers in which these invoices were recorded.

Finally, former ABNH senior management also signed a false and misleading management representation letter in connection with the auditors' review of ABNH's fiscal year 1997 financial statements. Among other things, the letter falsely stated that: (1) "[t]here has been no fraud involving management or employees who have significant roles in internal controls;" (2) "[t]here are no transactions that have been improperly recorded in the accounting records underlying the financial statements;" (3) "[w]e have fully disclosed to you all sales terms including all rights of return . . .;" and (4) "receivables at December 31, 1997 . . . do not include any amounts for goods shipped on consignment or approval." The management representation letter also falsely confirmed that "bill and hold" sales which occurred during fiscal year-end 1996, as well as the large "bill and hold" sale which occurred in the fourth quarter of 1997, accorded with certain criteria outlined under AAER 108.

3 ABNH's Improper Recognition of Revenue on Fiscal Year 1998 Transactions

The need to report strong revenue and net income was never more critical than in fiscal year 1998 given ABN's decision to sell ABNH through an IPO. Reporting sustained revenue and earnings growth during the first quarter of fiscal 1998, the reporting period leading up to the IPO, would enhance ABNH's spin-off value and, ultimately, redound to the benefit of ABN, which intended to use the proceeds from the transaction to pay down its significant debt. Also, reporting strong revenue and earnings during the second and third quarters of

fiscal year 1998, would solidify investor confidence in ABNH as a public company.

a) First Quarter of Fiscal Year 1998: Improper Revenue Recognition on Consignment Sales, Recognizing Revenue on Product that was Never Shipped, and Recognizing Revenue on Product that was Returned

ABNH continued to recognize revenue on improperly recorded consignment sales with various customers in the first quarter of fiscal year 1998, improperly recognizing a total of approximately \$1.9 million in revenue. In addition to improperly recorded revenue on consignment sales, ABNH further inflated its revenue and net income in the months leading up to its IPO by recognizing revenue on alleged sales to customers who never received any goods and, at times, recognizing revenue on shipments ABNH knew would be returned. This conduct further increased ABNH's revenue by approximately \$1.6 million during the first quarter of fiscal year 1998.

b) The Second and Third Quarters of Fiscal Year 1998: Improper Revenue Recognition on Consignment Sales and on Shipments to Warehouses, Recognizing Revenue on Product that was Never Shipped, and Recognizing Revenue on Product that was Returned

ABNH went public during its third quarter of fiscal year 1998, on or about July 15, 1998. Its first filings as a public company were made on Form 10-Q for the second and third quarters of 1998. During this period, ABNH improperly recognized approximately \$1,397,000 in revenue for improperly recorded consignment sales.

In addition, in June 1998, weeks before ABNH's IPO, ABNH entered into a warehousing arrangement with a third-party. ABNH then began to ship large quantities of holograms to this third-party warehouse, as well as occasional shipments to other third-party warehouses. ABNH recognized revenue on all these shipments, some of which involved consignment sales. A great number of the shipments to this warehouse were made without a customer purchase order and without the customer's knowledge, authorization or approval. ABNH, however, recognized revenue after shipping holograms to the warehouse where they sat for months. This practice involved approximately eleven customers and amounted to improperly recognized revenue of over \$5.8 million during the second and third quarters of fiscal year 1998.

During this time, separate and apart from the products placed in the third party warehouse, ABNH continued to recognize revenue in instances where the customer never issued purchase orders. In these cases, ABNH either never shipped the holograms to these customers or shipped holograms that were returned shortly after being shipped. In total, these practices involved seven customers and amounted to improperly recognized revenue of approximately \$5 million during the second and third quarters of fiscal year 1998.⁸

c) Fourth Quarter 1998

As ABNH approached its fiscal year-end, it was obvious to former senior management that the company was going to fall short of its revenue and earnings budget. To make up for this shortfall, ABNH improperly recognized over \$11.3 million in revenue on its books and records for

the fourth quarter of fiscal year 1998.⁹

This amount included, among other things, improperly recorded consignment sales, improperly recorded revenue on shipments to third-party warehouses, recognizing revenue on product that was never shipped, recognizing revenue on product that was returned, and recognizing revenue on the shipment of defective goods. In one instance, ABNH shipped scrap material and empty boxes to a customer, without receiving a purchase order, and recognized revenue of almost \$4 million on the alleged sale to that customer. In another instance, ABNH shipped test material to a customer, without receiving a purchase order, and recognized revenue of nearly \$2 million on the alleged sale to that customer.

4 ABNH Violated the Foreign Corrupt Practices Act

In late 1998, ABNH also violated the anti-bribery provisions of the Foreign Corrupt Practices Act ("FCPA"). ABNH employed agents who were responsible for seeking out new business in various regions of the world. These agents were generally compensated on a commission basis for any business they generated for the company. In late 1998, one of ABNH's agents informed an ABNH employee of an opportunity to bid on a contract to produce holograms for a foreign government. In an effort to win the contract, former ABNH officers authorized and directed an ABNH employee to wire \$239,000 to a bank account for the benefit of one or more officials of that foreign government. The employee wired the money as instructed and ABNH accounted for this payment as a consulting fee. This \$239,000 payment comprised nearly 40% of the contract's value and constituted an additional payment ABNH made for the purpose of influencing or affecting the acts or decisions of one or more of the foreign officials, or of the foreign government, in order to assist ABNH in obtaining or retaining business with the foreign government.

5 The Discovery of the Fraud and ABNH's Response

In November 1998, ABNH's auditors, in the course of performing their pre-audit procedures, circulated requests for information to certain of ABNH's customers. When the auditors received the customer responses, they discovered that some customers had invoices showing dollar amounts different from the amounts reflected on ABNH's versions of the same invoices. This led to an inquiry by ABNH and its auditors that resulted in ABNH's Audit Committee retaining counsel to conduct an internal investigation.

Upon learning of the improper conduct at ABNH, the company promptly reported the discovery of that conduct and its attendant accounting irregularities to the Commission staff. The company conducted a thorough internal investigation and apprised the Commission staff of its findings and cooperated with the staff in its investigation of this matter. All of ABNH's former senior management, including its Chairman and Chief Executive Officer, President, Vice President of Finance and Controller have resigned or have been terminated and the Company has put in place a new management team. Former management failed to put in place proper policies and procedures and did not have a written policy prohibiting the violations of law that occurred. The new management has instituted new policies and procedures including a

written Code of Business Conduct. This Order and the complaint filed contemporaneously herewith relate to events that occurred in 1996, 1997, and 1998, and not the current practices of ABNH. As noted, *infra*, in Section IV, the Commission considered ABNH's prompt remedial acts and cooperation in imposing the relief set forth in this Order.

On December 22, 1999, ABNH, following the completion of its internal investigation, filed its Form 10-K for fiscal year 1998 and restated its financial statements for fiscal years 1996 and 1997, each quarter in 1997 and the first three quarters of 1998. The effect of the restatements on ABNH's previously filed financial statements is summarized *supra* at Part III (B).

B) Violations

1 ABNH Violated the Antifraud, Reporting, Recordkeeping and Internal Controls Provisions of the Exchange Act

Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, prohibit material misstatements or omissions, made with scienter, in connection with the purchase or sale of securities. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-62 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). Scienter is the "mental state embracing the intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

Section 17(a)(1) of the Securities Act prohibits a person, in the offer or sale of any securities, from making untrue statements of material fact or from omitting to state material facts. See, e.g., U.S. v. Naftalin, 441 U.S. 768, 771-72 (1979). In addition, Section 17(a)(2) of the Securities Act prohibits a person, in the offer or sale of any securities, from obtaining money by means of untrue statements of material fact or omissions of material fact. Section 17(a)(3) prohibits a person, in the offer or sale of any securities, from engaging in any transaction, practice or course of business that operates or would operate as a fraud upon a purchaser. Scienter is required to violate Section 17(a)(1) but not Sections 17(a)(2) and (a)(3). Aaron v. SEC, 446 U.S. 680, 694 (1980).

A fact is material if there is a substantial likelihood that a reasonable investor would consider the information to be important. Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). Misrepresentation of a company's earnings, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969), and the improper recognition of revenue in departure from GAAP, see Fine v. American Solar King Corp., 919 F.2d 290, 297, 300-01 (5th Cir. 1990), may be material.

Section 13(a) of the Exchange Act, and Rule 13a-13 thereunder, require issuers whose securities are registered with the Commission pursuant to the Exchange Act to file quarterly reports. Such reports must be true and correct. See SEC v. Savoy Industries, 587 F.2d 1149, 1165 (D.C. Cir. 1978). Rule 12b-20 requires that such reports include all material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. Pursuant to the instructions applicable to Form 10-Q,

financial statements contained therein must conform to Regulation S-X, which, in turn, requires conformity with GAAP. 17 C.F.R. § 210.4-01(a)(1).

Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements*, paragraphs 83 and 84, provides that revenue should not be recognized until it is (1) realized or realizable and (2) earned. Revenue is realized or realizable when products are exchanged for cash or for assets that are readily convertible to cash or claims to cash. *Id.* Revenue is earned when the entity has substantially accomplished what it must do (generally including delivery to the customer) to be entitled to the benefits represented by the revenue. *Id.* ABNH recognized revenue on numerous transactions before the revenue was realized or realizable and earned.

ABNH violated Section 17(a) of the Securities Act, Sections 10(b) and 13(a) of the Exchange Act, and Rules 10b-5, 12b-20, and 13a-13 thereunder, by filing with Commission in July 1998 a Registration Statement on Form S-1 that contained materially false and misleading financial statements for the fiscal years ended December 31, 1996 and 1997, and the quarter ended March 31, 1998, as well as unaudited operating results for fiscal year 1997 and the first quarter of fiscal year 1998, and by filing with the Commission Forms 10-Q in 1998 that contained materially false and misleading financial statements for the quarters ended June 30 and September 30, 1998. In fiscal year 1996, ABNH improperly recognized approximately \$1.9 million of revenue, resulting in approximately a \$962,000, or 22% overstatement of net income. In fiscal year 1997, ABNH improperly recognized approximately \$7.8 million of revenue, resulting in approximately a \$4.7 million, or 167%, overstatement of net income. In the second quarter of fiscal year 1998, ABNH improperly recognized approximately \$5.0 million of revenue, resulting in approximately a \$1.9 million, or 489%, overstatement of net income, and in the third quarter of fiscal year 1998, ABNH improperly recognized approximately \$5.4 million of revenue, resulting in approximately a \$2.5 million, or 843% overstatement of net income.

Section 13(b)(2)(A) of the Exchange Act requires that every issuer of securities registered pursuant to Section 12 of the Exchange Act make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect its transactions and disposition of assets. ABNH violated Section 13(b)(2)(A) of the Exchange Act by maintaining false and misleading books and records in fiscal years 1996, 1997, and 1998, which, among other things, materially overstated the company's revenue and net income in fiscal years 1996, 1997 and 1998. Among other things, ABNH failed to properly account for consignment sales, "bill and hold" sales, and a payment for the benefit of a foreign government official, which it misleadingly characterized as a consulting fee. Moreover, ABNH's books, records, and accounts documented a number of transactions that did not take place.

Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP. ABNH violated Section 13(b)(2)(B) of the Exchange Act by failing to

devise and maintain a system of internal accounting controls sufficient to prevent, among other things, the recording of improper consignment sales, improper "bill and hold" transactions, and outright fictitious sales. ABNH also devised an off-line system of accounting controls to keep track of consignment sales the company made which were not recorded in conformity with GAAP.

2 The Anti-bribery Provisions of the FCPA

Section 30A (a) of the Exchange Act, the anti-bribery provision of the FCPA, prohibits, in part, any issuer which has a class of securities registered pursuant to Section 12 of the Exchange Act or any officer, director, employee, or agent of such issuer, from making use of the mails or any means or instrumentalities of interstate commerce corruptly in furtherance of an offer, payment, promise to pay or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to (1) any foreign official for purposes of (A)(i) influencing any act or decision of such foreign official in his official capacity, or (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, (B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

ABNH violated Section 30A of the Exchange Act when it wired \$239,000 to a foreign bank account for the purpose of influencing or affecting the acts or decisions of one or more foreign officials, or of the foreign government, in order to assist ABNH in obtaining or retaining business with the foreign government.

Based on the foregoing, the Commission finds that ABNH violated Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A) and (B), and 30A of the Exchange Act, and Exchange Act Rules 10b-5, 12b-20, and 13a-13.

IV.

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

V.

Based on the foregoing, the Commission deems it appropriate to accept the Respondent's Offer and to impose the relief specified therein.

ACCORDINGLY, IT IS HEREBY ORDERED that, pursuant to Section 8A of Securities Act and Section 21C of the Exchange Act, American Bank Note Holographics, Inc. cease and desist from committing or causing any violation, and any future violation, of Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A) and (B), and 30A of the Exchange Act, and Exchange Act Rules 10b-5, 12b-20, and 13a-13.

By the Commission

Jonathan G. Katz

Secretary

Footnotes

- ¹ The findings herein are made pursuant to the Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.
- ² ABN filed for Chapter 11 bankruptcy on December 8, 1999.
- ³ Respondent filed a Registration Statement on Form S-1 with the Commission, in order to effect its IPO, which included audited financial statements for its fiscal years 1996 and 1997 as well as the interim 1997 quarters and the first quarter of fiscal year 1998.
- ⁴ In a departure from the general rule of revenue recognition, which holds that revenue is recognized when, among other things, delivery has occurred, a "bill and hold" transaction is generally a practice "whereby a customer agrees to purchase the goods but the seller retains physical possession until the customer requests shipment to designated locations." In the Matter of Arthur Andersen & Co., SEC Exchange Act Release No. 17878 (June 22, 1981). The Commission's Accounting and Auditing Enforcement Release ("AAER") Number 108 states that revenue may be recognized on "bill and hold" sales only if certain conditions are met.
- ⁵ For example, instead of the customers requesting that the sales occur on a "bill and hold" basis, ABNH made the request. Second, the holograms ABNH sold to the customers had not been segregated from its general inventory and identified as belonging to the customers as of December 31, 1996.
- ⁶ The meaning of the term "reels" is discussed below.
- ⁷ See FASB Statement of Financial Accounting Concepts No. 5, providing, in part, that "revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues."
- ⁸ One of these customers had a "bill and hold" arrangement with ABNH which ABNH abused by recognizing revenue on alleged sales to that customer without first receiving purchase orders.
- ⁹ ABNH did not file a Form-10K for fiscal year 1998 until December 1999, after it had completed its restatement. As a result, this improperly recognized revenue was never reported to the public.

<http://www.sec.gov/litigation/admin/33-7994.htm>