

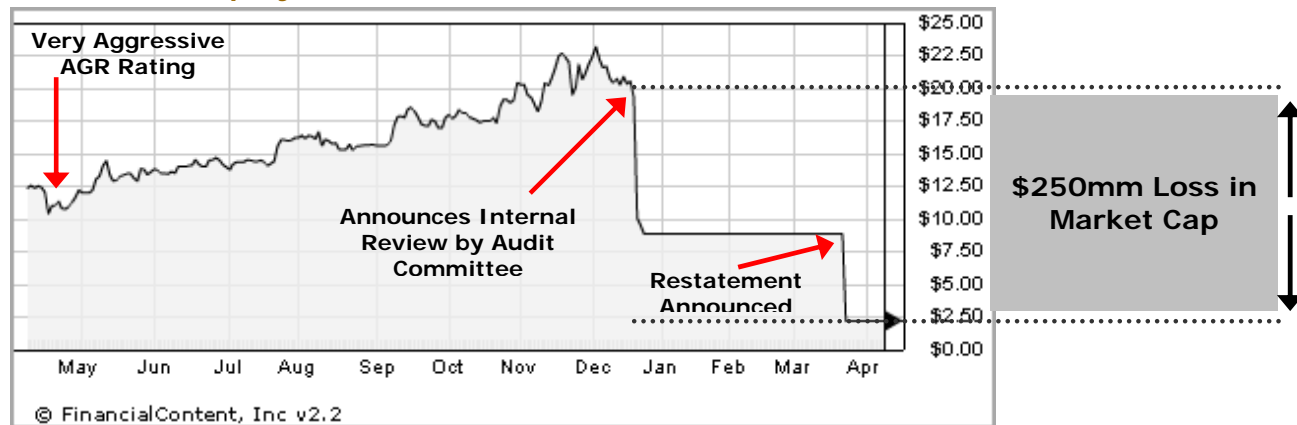
## SeraCare – Undue Influence on Accounting Integrity

### Restatement, Litigation, SEC Subpoenas and Severe Equity Loss

SeraCare Life Sciences (SRLS) removed four key people, filed for bankruptcy, and was delisted from Nasdaq after a material restatement in March of 2005<sup>1</sup>. Several investor class action litigations have followed alleging that the company's stock price was inflated through *fraudulent* accounting practices. SEC subpoenas and severe equity loss have ensued. Audit Integrity identified this risk several quarters prior.

The company announced in March that it would restate financial statements for one or more of the first three quarters of fiscal 2005, primarily due to inventory accounting and revenue-recognition errors. According to the Union-Tribune, the company initiated an internal investigation in December *after* its independent auditor, Mayer Hoffman McCann, revealed **possible undue influence by directors on financial reporting and auditing**<sup>1</sup>. Accordingly the company fired the Chairman, CEO, CFO and one other director. The equity chart for SRLS is included below.

#### SRLS 1 Year Equity Chart



Audit Integrity flagged revenue recognition broadly for SRLS for the last four consecutive quarters and specifically flagged inventory, accounts receivable and operating revenue within the Revenue Recognition risk category. A snippet of the Audit Integrity Risk History Report is included below.

#### SRLS Risk History Report

AGR Hierarchy				Historical Quarters (AGR Scores/Red Flags)											
				06/05	03/05	12/04	09/04	06/04	03/04	12/03	09/03	06/03	03/03	12/02	09/02
Risk	Issue	Metric	Operation	47	50	28	36	59	60	59	62	67	61	64	49
<input type="checkbox"/>	Revenue Recognition			🚩	🚩	🚩	🚩			🚩			🚩	🚩	🚩
<input type="checkbox"/>	Operating Revenues over Operating Expenses			🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩
<input type="checkbox"/>	Accounts Receivable over Sales						🚩			🚩	🚩	🚩	🚩	🚩	🚩
<input type="checkbox"/>	Inventory over Operating Revenues			🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩	🚩

<sup>1</sup> Stephen Taub, CFO.com, April 10, 2006

For all three of the Revenue Recognition metrics, it was the industry comparison test that was flagged as an outlier. Most improper asset valuations involve the fraudulent overstatement of inventory which can be manipulated through a number of schemes such as: falsified or fictitious inventory count, obsolete/scrap inventory not reserved for, inventory not valued at LCM, consigned inventory not properly accounted for, overpricing of inventory costs, or a transfer of expenses out of Cost of Goods Sold into the inventory balance. SRLS's inventory accounting has been flagged for twelve consecutive quarters or 3 straight years by Audit Integrity.

Audit Integrity also flagged SRLS for a number of Asset-Liability Valuation metrics including the growth in Gross Operating Leases which were a part of two acquisitions in 2004 and booked as off balance sheet obligations of over \$14 million. In total the company has rated Aggressive or Very Aggressive for five consecutive quarters, including the period of restatement and well before the alleged fraud was uncovered.

### **Conclusion**

SRLS is one example of many that companies which demonstrate a pattern of opaque behavior as measured by Audit Integrity are at greater risk of SEC Enforcement Actions, class action litigation, material financial restatements and severe equity loss. In this case, SRLS may suffer all four.

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