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## SEC Charges Audit Committee Chair and Others in Accounting Fraud Case

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In a complaint filed March 11, 2014, the Securities and Exchange Commission charged AgFeed Industries, Inc. (“AgFeed”) with violations of the securities laws based on accounting fraud. AgFeed is a hog production and animal nutrition company, now in bankruptcy, which operated in China and the United States. According to the complaint, AgFeed reported false revenues from its China operations between 2008 and June 30, 2011. As a result of the purported fraud, AgFeed’s revenues were allegedly inflated by approximately \$239 million over that period.

The SEC’s allegations describe a multi-year fraud led by four former members of AgFeed’s Chinese management. According to the complaint, to increase revenues, management directed AgFeed employees to manipulate hog weights, book false sales of hogs, and later report that the fake hogs had died. To cover up the fraud, the Chinese business allegedly maintained two sets of books: one recorded the business’s true financial position, and one—shared with US management—recorded inflated revenue and profits. As a result of this fraud, AgFeed’s SEC filings and public statements reporting revenues during the period were materially false. The complaint also alleges that certain public statements relating to AgFeed’s performance were false as well, as a result of the fraud.

Notably, the SEC has sued the US-based chair of the audit committee, along with other executives. According to the SEC, the audit committee chair and CFO each became aware of the fraud by June 2011. A company advisor recommended to the chair that AgFeed hire professional investigators to review the business, noting in an email “that the ‘Jiangxi issues’ were ‘not just smoke but fire.’” Rather than hire a third-party to investigate, however, the chair ordered an internal investigation by members of AgFeed’s management team. The SEC alleges that the chair and CFO “had strong financial incentives to conceal the China fraud.” And, in fact, the chair and CFO “did not reveal to AgFeed’s outside auditors, outside disclosure counsel, or new CFO the most significant evidence of the fraud. Instead, from June through September 2011, [they] gave the false impression that the investigation had not revealed anything to show that the fraud was material.”

The case is noteworthy for a couple of reasons:

- First, it is a manifestation of the SEC’s renewed focus on accounting fraud and

gatekeepers, including auditors, CFOs, board members, and lawyers.

- Second, the SEC enforcement staff has now carried out its expressed intention to seek to charge audit committee members for failing to act on “red flags.” (Learn more in a [previous post](#).)

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