

ORDER

III.

On the basis of Respondent's Offer, the Board finds^{1/} that:

A. Respondent

1. Nakao, age 34, of Murray, Utah is a certified public accountant licensed under the laws of the state of Utah (License No. 5247207-2601). At all relevant times, she was a professional in the Salt Lake City, Utah office of the registered public accounting firm of Grant Thornton, LLP ("GT") and 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 Respondent's violations of PCAOB Rules and auditing standards in connection with GT's audit of the fiscal year ("FY") 2004 financial statements of Imergent, Inc. ("Imergent" or the "Company"). Respondent's violations occurred in the context of auditing Imergent's (1) revenue, (2) allowance for doubtful accounts, and (3) related financial statement footnote disclosures.

3. GT became the independent auditor for Imergent in February 2002. Respondent began working on the Imergent audit in FY 2002 as the engagement senior. She was promoted to manager in July 2003 and became the manager on the Imergent engagement in FY 2004. She remained a member of the Imergent engagement team until GT was terminated as the company's independent auditor in

^{1/} 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. The sanctions that the Board is imposing in this Order may be imposed only if a respondent's conduct meets one of the conditions set out in Section 105(c)(5) of the Act, 15 U.S.C. § 7215(c)(5). The Board finds that Respondent's conduct described in this Order meets the condition set out in Section 105(c)(5), which provides that such sanctions may be imposed in the event of: (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

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October 2005. Respondent was the only GT professional staffed on the Imergent engagement for all three fiscal years audited by GT.

4. Most of Imergent's FY 2004 revenue came from sales of software licenses to customers who were given 24-month extended payment term arrangements ("EPTAs") to finance their purchase. Under applicable Generally Accepted Accounting Principles ("GAAP"), Imergent could recognize revenue from EPTA-financed sales ("EPTA sales") on an accrual basis (*i.e.*, at the time the sale was completed, rather than when cash was ultimately received) only if, among other things, the sales fee was probable of collection and the fee was fixed or determinable. Respondent understood that for the EPTA sales fee to be deemed fixed or determinable, Imergent had to have a history of successfully collecting under the original payment terms without making concessions. Respondent also was aware that Imergent recognized all revenue from EPTA sales on an accrual basis despite having a history of poor collections and a practice of extending financing to all customers regardless of their credit history.

5. Respondent understood that Imergent's historical collection experience for EPTA sales was its primary basis for concluding that the FY 2004 EPTA sales were probable of collection and fixed or determinable. But Respondent failed to ensure that the engagement team sufficiently tested management's representations of its historical collection experience for EPTA sales. In fact, during the FY 2004 audit, Respondent was aware of materially contradictory evidence as to the collection rates of Imergent's EPTAs, but failed to obtain reasonable assurance regarding the actual rates in light of this contradictory evidence.

6. Respondent further failed to ensure that sufficient procedures were performed to test or assess the reasonableness of certain EPTA collection rates disclosed by Imergent in the footnotes to its FY 2004 financial statements and in its filings with the Securities and Exchange Commission ("SEC").

7. During the FY 2004 audit, the engagement team also identified Imergent's allowance for doubtful accounts as a significant audit issue. In order to properly value its trade receivables balance, Imergent needed to reasonably estimate its allowance for doubtful accounts. The trade receivables balance was comprised primarily of payments due from EPTA sales. At the time of the FY 2004 audit, Respondent was aware that, during FY 2004, Imergent's management adopted a new methodology for estimating its allowance for doubtful accounts. Under the new methodology, the allowance as a percentage of gross trade receivables decreased from 47% as of June 30, 2003 to 32%

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as of June 30, 2004. This decrease in the allowance reduced bad debt expense, thereby increasing FY 2004 net income. Despite being aware of the new methodology, the inherent risks associated with this significant estimate, and Imergent's history of underestimating the allowance for doubtful accounts, Respondent failed to ensure the performance of sufficient procedures to assess the reasonableness of the June 30, 2004 allowance for doubtful accounts balance.

C. Respondent Failed to Comply with Certain PCAOB Auditing Standards in Auditing the Financial Statements of Imergent, Inc. for FY 2004

8. Imergent is an e-services company based, at all relevant times, in Orem, Utah.^{2/} Imergent's public filings disclose that it sold licenses to use a web-based software called StoresOnline Software ("SOS" or "software"), which assists customers in creating websites. Imergent's shares are listed on the American Stock Exchange. At all relevant times, Imergent was an issuer as that term is defined by Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

9. As manager on the FY 2004 Imergent audit, Respondent was responsible for supervising procedures performed by more junior members of the engagement team and for reviewing the team's work on revenue recognition and the allowance for doubtful accounts.^{3/} She also personally performed certain of the procedures in those areas during the FY 2004 audit and prior audits. In an audit report dated August 27, 2004, and included in Imergent's Form 10-K filed with the Securities and Exchange Commission on September 10, 2004, GT expressed an unqualified opinion on Imergent's consolidated balance sheets as of June 30, 2004 and 2003, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2004. GT's audit report stated that the audit had been conducted in accordance with the standards of the PCAOB, and that, in GT's opinion, Imergent's financial statements presented fairly, in all material respects, its financial position in conformity with U.S. GAAP.

^{2/} On April 27, 2009, Imergent announced that it was moving its headquarters from Orem, Utah to Phoenix, Arizona.

^{3/} See AU § 311.11 & .13, *Planning and Supervision*. The auditor with final responsibility for the audit delegated portions of the supervision of the audit to Respondent. See AU § 311.02, *Planning and Supervision*.

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10. In connection with the preparation or issuance of an audit report, PCAOB rules require that associated persons of registered public accounting firms comply with the Board's auditing standards.^{4/} Under these standards, 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/} Among other things, those standards require that an auditor exercise due professional care, maintain professional skepticism, and obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements.^{6/} Respondent failed to comply with these standards in connection with the FY 2004 audit of Imergent.

Imergent's Business and Stratification of Sales

11. According to Imergent's FY 2004 Form 10-K, Imergent began selling the SOS license on October 1, 2000. During FY 2004, Imergent sold SOS licenses through promotional workshops held throughout the United States and in several foreign countries. Imergent disclosed that revenue from the sale of SOS licenses was recognized after the product was delivered to the customer and a three day rescission period expired.

12. Respondent was aware that Imergent accepted three methods of payment for the software: cash, credit cards, or EPTAs. Imergent entered into EPTAs with all purchasers of SOS licenses who made a 5% down payment, completed a credit application, and permitted Imergent to check their credit. The results of the credit check did not preclude a customer from qualifying for an EPTA.

^{4/} See PCAOB Rules 3100, 3200T.

^{5/} See AU § 508.07, *Reports on Audited Financial Statements*.

^{6/} See AU § 150.02, *Generally Accepted Auditing Standards*; AU § 230, *Due Professional Care in the Performance of Work*; AU § 326, *Evidential Matter*. Under PCAOB standards, representations from management are part of the evidential matter that an auditor obtains, but management representations are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for the auditor's opinion. See AU § 333, *Management Representations*.

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13. Respondent was aware that Imergent performed the credit check at the time of the workshop and, based on the credit check, stratified purchasers into two distinct groups: "A" customers and "B" customers. Customers with credit scores of 630 or higher were categorized as "A" customers and those with credit scores below 630 were categorized as "B" customers. According to the work papers, Imergent began tracking customers by credit score during FY 2002 and continued to do so throughout the time GT was its independent auditor. The work papers indicate that the majority of FY 2004 EPTA customers were "B" customers.

14. Respondent was aware that, during FY 2004, Imergent sold portions of its EPTA receivables at a discount. Imergent referred to these sold receivables as "funded EPTAs" and the remaining EPTA receivables as "non-funded EPTAs." Imergent used customer credit scores to determine which EPTAs were likely to be funded. Beginning in FY 2003, Imergent also used the distinction between "A" and "B" customers in developing its allowance for doubtful accounts. Imergent developed an allowance for "B" customers representing a significantly lower estimated rate of collections than for "A" customers. In making certain of its revenue recognition decisions, however, Imergent relied on the cumulative collection rate of all EPTA sales to conclude that revenue should be recognized on an accrual basis for sales to all types or classes of EPTA customers.

Imergent's Revenue Recognition Conclusions

15. According to Imergent's FY 2004 Form 10-K, the accounting for EPTA sales was required to comply with American Institute of Certified Public Accountants Statement of Position 97-2, *Software Revenue Recognition* ("SOP 97-2") and was identified as a critical accounting policy. In order to recognize revenue for the sale of an SOS license on an accrual basis pursuant to SOP 97-2, Imergent was required, among other things, to establish that the sale was probable of collection and that the fee was fixed or determinable.^{7/} During each year audited by GT, Imergent concluded that all EPTA sales were probable of collection and the sales price was fixed or determinable.

^{7/} Paragraph .08 of SOP 97-2 states:

If the arrangement does not require significant production, modification, or customization of software, revenue should be recognized when all of the following criteria are met:

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16. After Imergent's revenue recognition conclusions were questioned by the staff of the SEC's Division of Corporation Finance in May 2005, Imergent announced, on August 19, 2005, that, after consultation with GT, it would "correct its historical revenue recognition policy to cash basis from accrual basis for fiscal years 2002, 2003, 2004 and the first three quarters of fiscal 2005 in order to comply [with GAAP]." In October 2005, Imergent terminated GT as its independent auditor and, subsequently, restated its FY 2004 and 2003 financial statements in conjunction with filing its FY 2005 financial statements.

The FY 2004 Audit

17. According to work papers reviewed by Respondent, EPTA sales grew considerably in FY 2004, nearly doubling from \$22.5 million in FY 2003 to \$44.3 million in FY 2004. EPTA sales comprised nearly 55% of Imergent's total reported FY 2004 revenue of \$81 million.

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- Persuasive evidence of an arrangement exists.
 - Delivery has occurred.
 - The vendor's fee is fixed or determinable.
 - Collectibility is probable.

With regard to whether the fee is "fixed or determinable," Paragraph .28 of SOP 97-2 provides that:

... if payment of a significant portion of the software licensing fee is not due until after expiration of the license or more than twelve months after delivery, the licensing fee should be *presumed* not to be fixed or determinable. However, this presumption may be overcome by evidence that the vendor 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.

(italics in original; underlining added). Paragraph .29 provides that if the presumption cannot be overcome "revenue should be recognized as payments from customers become due (assuming all other conditions for revenue recognition in this SOP have been satisfied)."

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Probability of Collection

18. Respondent knew that Imergent had concluded that its FY 2004 EPTA sales were probable of collection based primarily on its historical collection experience. But Respondent failed to ensure that the engagement team sufficiently tested management's representations of its historical collection experience. In fact, during the 2004 audit, Respondent was aware of materially contradictory evidence as to the collection rates of Imergent's EPTAs, but failed to obtain reasonable assurance regarding the actual rates in light of this contradictory evidence.^{8/}

19. The engagement team's analysis of the appropriateness of Imergent's revenue recognition policies is documented in a memorandum addressing revenue recognition (the "Revenue Recognition Memo") included in the FY 2004 audit work papers and reviewed by Respondent. In discussing SOS sales in the Revenue Recognition Memo, the engagement team asked "[i]s collection probable on sales under [EPTAs]?" In response, the memo states:

The Company's position is that collection of the fee is probable since, on average, 70% of EPTA fees are paid. An analysis of the payment types and [EPTAs] delineated previously in this document shows that approximately 100% of cash and credit card payments are collected, approximately 98% of funded [EPTAs] are collected, and approximately 47% of non-funded [EPTAs] are collected. These percentages have been reasonably consistent and the Company is able to accurately estimate the percentage of bad debt likely to occur in a given classification of [EPTAs].

CONCLUSION: The Company's position that the collection of the workshop fees is probable is appropriate. The Company recognizes bad debt expense in the period in which the bad debt is expected to have occurred. History has shown that payments under [EPTAs] are probable of collection, notwithstanding the fact that the bad debt percentage is very high on certain classes of [EPTAs]."

^{8/} See AU § 333.04 ("If a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made").

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20. Respondent did not ensure that the EPTA collection percentages in the Revenue Recognition Memo were tested for reliability, even though the percentages were identical to the percentages in the previous year (and, for all but one figure, identical to the collection percentages from two years prior),^{9/} and other information reviewed by Respondent showed a worsening collection history.^{10/}

21. The FY 2004 work papers contain two documents analyzing Imergent's historical collection rates. They are: (1) a series of company-prepared spreadsheets analyzing Imergent's collections for the last six months of FY 2004 ("Six Month Analysis"),^{11/} and (2) a company-prepared ratio analysis ("Ratio Analysis"). Both documents were reviewed by Respondent during the audit. Neither document provided sufficient competent evidential matter to support management's assertion that EPTA sales were probable of collection.^{12/}

22. The Six Month Analysis did not provide a basis for concluding that EPTA sales were probable of collection because, among other things, it consisted of insufficiently tested management representations and included data that did not allow for a meaningful analysis of historical collection rates. In fact, during the FY 2004 audit, Respondent became aware of problems that inflated certain of the EPTA collection rates reflected in the Six Month Analysis, but she failed to assess the cumulative impact of those problems on the reliability of the analysis.

^{9/} The purported collection percentages for FY 2003 and FY 2004 were identical, and differed in only one respect from those in FY 2002; *i.e.*, one number shown as 45% in the FY 2002 work papers became 47% in the FY 2003 and 2004 work papers.

^{10/} See AU § 230.07 ("Due professional care requires the auditor to exercise *professional skepticism*. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence.") (italics in original).

^{11/} The Six Month Analysis is included in a GT work paper entitled "Allowance for Bad Debts Workbook."

^{12/} See AU § 326.



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23. The Ratio Analysis contradicted Imergent's assertion that its EPTA sales were probable of collection and put Respondent on notice that Imergent's recent collection history did not support its asserted collection rates. The Ratio Analysis disclosed that, as of June 30, 2004, Imergent had written off 69% of EPTAs originated in FY 2003 and had written off 53% of EPTAs originated in FY 2002. In other words, the Ratio Analysis indicated that for the prior two fiscal years, Imergent wrote-off more than 50% of the total amount of EPTA-financed sales. Further, the FY 2004 work papers include a Concluding Ratio Analysis, which was reviewed by Respondent and states that "installment contracts on average are about 47% collectible" Despite this contradictory information, Respondent failed to sufficiently test management's assertion that EPTA sales were probable of collection and that "on average, 70% of EPTA fees are paid."^{13/}

24. During the FY 2004 audit, Respondent failed to ensure that the engagement team obtained sufficient competent evidential matter to evaluate Imergent's historical collection rate for EPTAs or otherwise evaluate the primary basis for management's assertion that Imergent's EPTA sales were probable of collection. Moreover, Respondent failed to ensure that the engagement team took steps to determine how, in light of the representations in the Ratio Analysis, Imergent maintained its assertion that all EPTA-financed sales were probable of collection. Respondent improperly relied on management representations as a substitute for ensuring that sufficient procedures were performed to reasonably conclude on whether EPTA sales were probable of collection. Finally, despite knowing that Imergent grouped EPTA customers into categories with substantially different historical collection rates, Respondent failed to obtain sufficient competent evidential matter to accept Imergent's conclusion that the collection histories of all types and classes of EPTA sales could be combined to determine whether EPTA sales were probable of collection, and failed to assess adequately whether Imergent could properly recognize revenue on an accrual basis for sales to customers with inferior credit scores.

^{13/} See AU § 326.25 ("In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. To the extent the auditor remains in substantial doubt about any assertion of material significance, he or she must refrain from forming an opinion until he or she has obtained sufficient competent evidential matter to remove such substantial doubt").

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Fixed or Determinable

25. In addition to satisfying the probability of collection requirement, Imergent had to establish that the EPTA sales fee was fixed or determinable before revenue could be recognized on an accrual basis. Respondent understood that an EPTA-financed sales fee was presumed not to be fixed or determinable under SOP 97-2 because payment of a significant portion of the fee was not due until more than 12 months after delivery. However, Imergent could overcome this presumption if it had "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."^{14/} Imergent represented to GT that it overcame the presumption.

26. Respondent was aware that Imergent concluded that it had a history of successfully collecting EPTA sales fees based on the same historical collection experience it used to assess whether its EPTA sales were probable of collection. Yet, as previously described, Respondent did not ensure that the engagement team sufficiently tested the historical collection experience of EPTAs. Thus, the engagement team failed to perform sufficient procedures to adequately assess whether Imergent had a history of successfully collecting under the original payment terms without making concessions. Consequently, the engagement team did not obtain sufficient competent evidential matter to evaluate management's assertion that the fees from EPTA sales were fixed or determinable.

Financial Statement Revenue Recognition Disclosures

27. In the footnotes to the FY 2004 financial statements, Imergent disclosed that "[d]uring fiscal years ended June 30, 1999 through 2004, the Company has collected or is collecting approximately 70% of all EPTAs issued to customers ... Despite reasonable efforts, approximately 47% of all EPTAs not sold to third party financial institutions become uncollectible during the life of the contract." Respondent failed to ensure that the engagement team performed sufficient procedures to assess whether the collection rates disclosed in the financial statement footnotes were reasonably accurate.

^{14/} SOP 97-2 Paragraph .28.

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28. Respondent reviewed certain FY 2004 work papers which document without specific citations that the 70% and 47% figures were purportedly traced to support elsewhere in the work papers. The only place in the work papers where similar figures are found is in the Revenue Recognition Memo. Tracing the figures to the Revenue Recognition Memo, however, did not provide sufficient competent evidential matter to assess their reasonableness because the Revenue Recognition Memo figures consist of untested management representations that were contradicted by other evidence in the work papers, including the 2004 Ratio Analysis and the Concluding Ratio Analysis.^{15/}

Allowance for Doubtful Accounts

29. Imergent's FY 2004 financial statements disclose that its customers owed Imergent \$27.9 million as of June 30, 2004. Imergent referred to these amounts due from customers as trade receivables and reflected the amounts as assets on their balance sheet. Because Imergent expected that some of its trade receivables would not be paid, it estimated how much would not be collected. This amount is referred to as an allowance for doubtful accounts. As of June 30, 2004, Imergent recorded an allowance for doubtful accounts of \$9 million, meaning it expected to collect approximately \$18.9 million of its trade receivables balance. Net trade receivables (\$18.9 million) comprised approximately 47% of total assets as of June 30, 2004 and was described in the work papers as a significant issue. Respondent reviewed company-prepared schedules calculating the allowance.

30. As documented in work papers reviewed by Respondent, Imergent had a history of under-estimating its allowance for doubtful accounts. During FY 2003, Imergent determined that it had significantly underestimated its June 30, 2002 allowance. According to the work papers, Imergent learned during FY 2004 that it had again under-estimated its allowance for doubtful accounts estimate, this time the June 30, 2003 estimate.

31. Respondent knew that, during FY 2004, Imergent's management adopted a new methodology for estimating its allowance for doubtful accounts. The methodology used at year-end contained numerous new assumptions that were not tested by the engagement team for reasonableness. Under the new methodology, the

^{15/} See AU § 326.

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allowance for doubtful accounts as a percentage of gross trade receivables decreased to 32% as of June 30, 2004 from 47% as of June 30, 2003. In documentation reviewed by Respondent, this trend was identified as being contrary to the engagement team's expectation that the allowance would be 51% of trade receivables as of June 30, 2004. The engagement team obtained no evidence supporting the lower than expected allowance except management's representation as to the reason.

32. Respondent failed to ensure that adequate procedures were performed to (1) assess the reasonableness of the assumptions utilized in the new allowance methodology and (2) test the accuracy of the source data used by management to calculate the FY 2004 year-end allowance estimate.^{16/}

IV.

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

Pursuant to Section 105(c)(4)(B) of the Act and PCAOB Rule 5300(a)(2), Jennifer Nakao is suspended 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), for a period of one year from the date of this Order.

ISSUED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

February 17, 2010

^{16/} See AU § 326.