

Independent Investment Research Focused on Public Company Interactions with the SEC.

Disclosed SEC Investigation Confirmed as On-going

Cisco's China FCPA Probe Not Going So Well

Be careful here. In late 2020, we first warned about an undisclosed SEC investigation at Cisco Systems. In Feb-2021, Cisco then disclosed an Foreign Corrupt Practices Act (FCPA) investigation involving China. A subtle and recent change in the related disclosure language tells us management now thinks **Cisco's China FCPA probe will have a material adverse effect on operations and cash flows.** Previously, the company explicitly said it would not. We think most people missed this language change, which we highlight in today's report. Further, our earlier work found Cisco knows exactly what it is doing when it comes to disclosing FCPA matters. They hide things. Ignore the recent change in disclosure language at your peril.

– John P. Gavin, CFA

Facts of Interest or Concern

In late 2020, we first warned about an undisclosed SEC investigation at Cisco. In Feb-2021, the company then, and first, disclosed a FCPA investigation involving China. In May-2021, Cisco repeated the initial disclosure it made in February. But the filing of the 10-K last month, in Sep-2021, brought a subtle change in language that tells us things are not going so well for Cisco.

The first disclosure of Cisco's China FCPA probe, made in the Cisco 10-Q filed on 16-Feb-2021:

*China. The Company is investigating allegations of a self-enrichment scheme involving now-former employees in China. Some of those employees are also alleged to have made or directed payments from the funds they received to various third parties, including employees of state-owned enterprises. **The Company voluntarily disclosed this investigation** to the Department of Justice ("DOJ") and Securities and Exchange Commission ("SEC"). We take such allegations very seriously and we are providing results of our investigation to the DOJ and SEC. While the outcome of our investigation is currently not determinable, **we do not expect that it will have a material adverse effect** on our consolidated financial position, results of operations, or cash flows.*

Quick Take: At the time of its Feb-2021 initial disclosure of its FCPA problem, Cisco claimed it, "voluntarily disclosed" an internal investigation to the DOJ and SEC.

Voluntarily disclosing an internal investigation to the DOJ and SEC is not the same as self-reporting. We know the SEC was already investigating Cisco as early as Aug-2020. We think it likely the company was "voluntarily" providing documents and records in response to that inquiry.

Further, Cisco said the usual blather many companies say when they're disclosing a material event such as a joint SEC/DOJ investigation. They assure you, "**we do not expect that it will have a material adverse effect**" ... even though they decided it was material enough to disclose.

The Danger for Investors Today

Let's go back to that initial disclosure of the FCPA investigation, first made in February 2021. In this case, we draw your attention to the following sentence:

*While the outcome of our investigation is currently not determinable, **we do not expect that it will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.***

This language cited just above was repeated in the **Cisco 10-Q filed on 25-May-2021**. The entire disclosure was essentially a cut-and-paste of the first one, with no update of any kind provided.

In the 10-K filed 09-Sep-2021, the FCPA disclosure changed.

Cisco dropped the language related to not expecting the investigation to have a material adverse effect on results of operations or cash flows. We highlight the disclosure change here –

From the 10-Q's filed in Feb-2021, and May-2021:

*While the outcome of our investigation is currently not determinable, **we do not expect that it will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.***

From the Cisco Systems 10-K filed on 09-Sep-2021:

*While the outcome of our investigation is currently not determinable, **we do not expect that it will have a material adverse effect on our Consolidated Financial Statements.***

Quick Take: There's a reason the company made this seemingly minor change in disclosure language: Cisco management determined they can no longer say, "we do not expect that it will have a material adverse effect on our consolidated financial position, results of operations, or cash flows."

In other words, **Cisco management now expects its China FCPA probe will have a material adverse effect** on operations and cash flows. Again, in earlier filings the company explicitly said it would not.

Cisco's China FCPA probe is not going so well now. These seemingly minor changes can easily signal earnings or operating shortfalls are on the way.

Ignore the recent change in disclosure language at your peril.

Closing this section, we point out that this recent change in disclosure language did not happen by accident. Cisco is a company that knows exactly what it is doing when it comes to disclosing FCPA matters.

The remainder of this report summarizes an earlier incident in which we found Cisco playing Disclosure Games® with investors over an FCPA probe.

Cisco's Disclosure Games®

The history shows Cisco management gave great thought to the words, timing, and location of their FCPA-related disclosures in the past. They're not new at gaming this.

Let's start with something from our earlier work. Here we see Cisco's Deputy Counsel asserting the company's commitment to ethics. Sounds nice, right? It's not.

Roxane Marenberg, Deputy Counsel
Cisco company blog post
7:11 pm EST, 23-Dec-2013

"Ethics and integrity are part of our DNA and ingrained in our culture and the way we conduct every aspect of our business."

This was part of the smoke Cisco spewed out to mask the initial disclosure of a FCPA probe in late Dec-2013. It appeared the company went out of its way to make sure this disclosure was made – but otherwise well hidden.

How do we know? First, the above statement appeared within a pre-holiday, off-the-radar, Cisco company blog posting. This was where Cisco buried disclosure of its FCPA probe. They even used this yawner of an unrelated headline, "[The Importance of Ethics in Global Business](#)".

Note also the date and time of the posting: At 7:11 pm EST on 23-Dec-2013. Wall Street had already left for the Christmas holidays. There was no press release. Cisco did file an 8-K the same day regarding stocks options for senior executives, but it was silent on the FCPA probe.

Ethics. Integrity. Part of your DNA. Uh-huh.

It took until the fourth paragraph of Cisco's pre-holiday blog posting to say it was involved in a FCPA probe. Even then, they did not call it that. Instead, we got this –

Cisco company blog post
7:11 pm EST, 23-Dec-2013

Recently, at the request of the Securities and Exchange Commission and the US Department of Justice, Cisco began an investigation into our business activities and discounting practices in Russia and other Commonwealth of Independent States in response to a communication those agencies had received. We are cooperating with the agencies and will fully share the results of our investigation with them. Despite the extensive investigation that we have undertaken thus far, we have found no basis to believe that Cisco's activities are in violation of any law, and indeed the information we were provided does not allege wrongdoing by any of Cisco's executive management. While this investigation is ongoing, we do not expect the outcome to have any material adverse effect on our business or operations.

Cisco executives clearly felt a need to disclose this FCPA exposure. But they also went out of their way to make sure no one would see it.

Not labelling this as a FCPA investigation was one more measure Cisco took to make sure this would not be picked up. But why?

This older FCPA probe did not make it into an official Cisco Systems SEC filing until the 10-Q was filed two months later, in Feb-2014 (top, right). Even people who make their living following FCPA investigations did not catch this until the 10-Q came out in Feb-2014.

At that time, with the FCPA probe disclosure no longer hidden away, media outlets picked up on it. Investors reacted negatively to the news.

Again, why would Cisco go to all this effort to disclose a material event but do everything possible to make sure no one sees the disclosure?

From the Cisco Systems 10-Q filed 20-Feb-2014:

At the request of the U.S. Securities and Exchange Commission and the U.S. Department of Justice, the Company is conducting an investigation into allegations which the Company and those agencies received regarding possible violations of the U.S. Foreign Corrupt Practices Act involving business activities of the Company's operations in Russia and certain of the Commonwealth of Independent States, and by certain resellers of the Company's products in those countries. The Company takes any such allegations very seriously and is fully cooperating with and sharing the results of its investigation with the Commission and the Department. While the outcome of the Company's investigation is currently not determinable, the Company does not expect that it will have a material adverse effect on its consolidated financial position, results of operations, or cash flows. The countries that are the subject of the investigation collectively comprise less than two percent of the Company's revenues.

Here's a thought: Remember that Cisco Systems 8-K that talked about stock and options awards for senior executives, cited above. It was an 8-K that just happened to also be released on 23-Dec-2013. You know, right before the holidays, just like the blog posting.

Let's just say that Cisco management would not have been the first to try to bury bad news when compensation and stock awards for senior executives was in play.

These people hide things. That we're still talking about this one more than 7 years later tells you Cisco was one of the best at doing it we've ever seen. *That's* why we say ignore the recent change in disclosure language at your peril.

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New SEC investigative activity could theoretically begin or end after the date covered by the latest information in this report, which would not be reflected here. The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced above. Companies with undisclosed SEC investigations are maintained on our Watch List of companies with undisclosed SEC investigations.

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