UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55954 / June 25, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2623 / June 25, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12666

In the Matter of **INTERNATIONAL BUSINESS MACHINES CORPORATION,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The United States Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against International Business Machines Corporation ("IBM" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "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 to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

In 2000 and 2001, IBM assisted Dollar General Corporation's commission of accounting fraud through a sham transaction. The transaction was conceived by an IBM Business Unit Executive (the "IBM BUE") and was designed to achieve a particular accounting result for Dollar General. In addition, IBM maintained inaccurate books and records in 2000 and 2001 that resulted from, among other things, revenue recognition errors by various IBM business units in a number of countries around the world that departed from Generally Accepted Accounting Principles ("GAAP").

In 1999, IBM and Dollar General agreed that Dollar General would lease new electronic cash registers from IBM to replace Dollar General's old Omron-brand cash registers. As originally planned, Dollar General would phase out the old registers and purchase the new IBM equipment over a multi-year period. In the second half of 2000, however, IBM, through the IBM BUE, suggested that Dollar General accelerate the roll-out of new IBM equipment by leasing for approximately $10 million all of the new equipment by the end of 2000. This would have the result of increasing IBM's revenue for fiscal year 2000. Dollar General initially rejected the proposal, however, due to an accounting problem. Specifically, if Dollar General replaced all of the Omron equipment, it would be required to write off the book value of that equipment as an expense. This "book loss" problem, as it became known, in turn, would have a negative impact on Dollar General's earnings for its fiscal year 2000, which ended February 2, 2001.

IBM, through the IBM BUE, devised a way to solve Dollar General's "book loss" problem. Specifically, the IBM BUE proposed that IBM would purchase the old Omron equipment for approximately $11 million. By selling the equipment at that price, Dollar General would avoid most of the negative consequences of having to write off the book value of the equipment that would have occurred if it simply replaced the old registers with the new IBM equipment. The proposed "purchase," however, was not a bona fide transaction because, among other reasons, IBM's purchase price for the Omron equipment was repaid to IBM by an offsetting increase in the amount that Dollar General was to pay for the new IBM equipment. In addition, although IBM agreed to buy the Omron equipment for more than Dollar General was going to pay for the new IBM registers, IBM knew that the Omron equipment was worthless, IBM intended to destroy it, and ultimately IBM never took possession of any of the sales registers. Nevertheless, the

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

"purchase" occurred and Dollar General removed the Omron equipment from its books and minimized the negative impact on its earnings in fiscal year 2000.

In addition, IBM in 2000 and 2001 maintained inaccurate books and records as a result of numerous discrete revenue recognition errors (many of which were errors with respect to the timing of recognition as between quarters and which were discovered and corrected by IBM) totaling approximately $577 million in revenues over that two-year period.

B. RESPONDENT AND RELATED ENTITY

IBM, headquartered in Armonk, New York, and incorporated in New York, manufactures and sells computer services, hardware and software. IBM stock is registered under Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

Dollar General Corporation, a Tennessee corporation headquartered in Goodlettsville, Tennessee, is a discount retailer of general merchandise. Dollar General's common stock is registered under Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.[2]

C. THE OMRON TRANSACTION

1. IBM Proposal For An Accelerated Roll-Out Is Rejected

In 1999, Dollar General decided to lease new electronic cash registers from IBM's Retail Store Solutions business unit to replace Dollar General's old Omron-brand cash registers over a multi-year roll-out period. In November of 2000, IBM, through the IBM BUE, suggested that Dollar General accelerate the roll-out of the new electronic cash registers by leasing all the 4,224 remaining registers under the agreement before December 31, 2000. IBM offered to lease the new equipment to Dollar General for approximately $10 million, which included a one million dollar discount to encourage Dollar General to agree to the deal. After receiving the proposal, Dollar General concluded that the negative impact on Dollar General's earnings for its fiscal year 2000 from writing off the remaining book value for the Omron registers would outweigh the benefit of the transaction.

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[2] On April 7, 2005, the SEC filed a settled enforcement action against Dollar General and certain of its former officers and employees in the United States District Court for the Middle District of Tennessee. Securities and Exchange Commission v. Dollar General Corp., et al., Civil Action No. 3:05-0283. Dollar General consented to the entry of a final judgment permanently enjoining it from violating the antifraud, internal controls, books and records, and periodic reporting provisions of the federal securities laws, specifically, Section 17(a) of the Securities Act of 1933 and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-11, 13a-11, and 13a-13 thereunder. The Commission's complaint included allegations relating to the Dollar General transaction with IBM that is one of the subjects of this Order.

Dollar General rejected IBM's offer on November 29, 2000, explaining to the IBM BUE that it was not worth it to Dollar General to acquire the new registers in 2000 because of the additional expense Dollar General would incur in writing off the remaining book value of the company's old equipment. Internal communications at IBM make clear that IBM understood Dollar General's accounting issue, specifically the write-off of the remaining book value, was a significant obstacle to completing the December 2000 roll-out of the IBM equipment.

2. IBM Proposes "Purchase" of Omron Registers To Solve Dollar General's Accounting Concern

On behalf of IBM, the IBM BUE devised and proposed a solution to, as he wrote in an e-mail, "help fix [Dollar General's] Omron book value issue." Specifically, IBM offered to "purchase" the Omron registers from Dollar General to accomplish the goal of helping Dollar General to minimize the impact of writing off the book value of Dollar General's Omron registers. On November 30, 2000, the IBM BUE contacted Dollar General's Treasurer and Dollar General's vice president of information services to discuss a proposal to address Dollar General's "accounting concerns." The proposal was that Dollar General lease, by December 31, 2000, all of the new equipment then currently scheduled to be leased in future years. If Dollar General agreed, IBM would "purchase" the Omron registers for a specified amount and would offset that purchase price by increasing the price Dollar General would pay to lease the new IBM registers by approximately the same amount. Initially, the proposal was that the Omron purchase price would be repaid immediately by Dollar General; ultimately, IBM agreed that its "purchase price" would be repaid over time by Dollar General as part of the financing arrangements for the new equipment.

At the same time that IBM agreed to "purchase" the Omron registers, the IBM BUE and various other IBM personnel knew that the Omron equipment was worthless. For example, an IBM Asset Manager had determined by December 5, 2000, that the Omron registers had no value to IBM and communicated this to an IBM Client Manager. The IBM Client Manager also understood that IBM was going to dispose of the Omron equipment it was planning to purchase from Dollar General. In addition, an IBM Business Operations Manager for the North American sales team for IBM's Retail Store Solutions checked with an IBM contractor to see if there was any market value for the Omron registers. The contractor told the IBM Business Operations Manager that there was no domestic resale value for the equipment. Finally, the IBM BUE ultimately told Dollar General that the Omron registers were worthless to IBM and that IBM intended to destroy them.

IBM allowed Dollar General to set the "purchase" price for the equipment. After considering the book value of the Omron registers, Dollar General determined that the best price would be between $10 million and $11 million and communicated that to IBM. Thus, IBM was asked to pay as much or more for the worthless Omron registers as IBM had proposed Dollar General would pay for the new IBM equipment.

The IBM BUE and others at IBM also understood from the outset that the purchase price it proposed to pay for the older registers would not be at risk because it would be repaid by Dollar General in the form of an increased lease price for the new equipment. In effect, there was no "purchase" of Omron equipment; instead the amount was to be a loan from IBM to Dollar General. Internal IBM documents make clear the relationship between the Omron purchase price and the offsetting price increase for IBM equipment. For example, in a December 3, 2000, email, the IBM BUE described the new price for the IBM equipment as $20,530,000 – over double the approximately $10 million originally contemplated. The new purchase price now took into account the price of the Omron equipment, which, at that time, was specified in the email as $10,030,000.

The entire transaction was to be financed by IBM. The financing terms for Dollar General were to involve "one payment of $10,030,000 in February 2001, and the rest [of the $20,530,000] deferred with a payment start date of August 2001." Under these terms, the portion of the purchase price attributed to the Omron equipment would be promptly reimbursed, while the amount Dollar General owed on the new IBM equipment would be financed over a longer period. Moreover, during the course of negotiations, there was a nexus between the price of the Omron equipment and the final price. For example, in a December 15, 2000 email written by the IBM BUE, he explained that since Dollar General was "now asking for the $10,030,000 to go to $11,030,000, we will need to do a similar analysis for $19,620,480 + $1,000,000 more in Omron for a new total of $20,620,480 financed."

It was clear to certain IBM and Dollar General personnel that the only reason for the purported purchase of the Omron equipment was to solve Dollar General's accounting issues. The IBM BUE, for example, wrote in a December 3, 2000 email that "a buyback of the Omron equipment will erase the book loss issue, removing this as an obstacle to a more rapid roll-out." In the same email, the IBM BUE also stated that the proposed purchase should "significantly reduce or eliminate any negative P&L issues, and remove the lurking book loss issue." In turn, as Dollar General evaluated the offer, the company was seeking to determine whether the new proposal put Dollar General in a better position than it would have been if it held to the original roll-out schedule. In a December 5, 2000 email, the IBM BUE wrote: "The Customer is evaluating two things. Can we help fix their Omron book value issue (which we can and have already agreed to) and what is the comparative [net present value] of our best offer in December versus their current plan of acquiring [the equipment] . . . ."

In addition, completing the Omron "purchase" would increase IBM's earnings for the quarter by allowing it to close the accelerated roll-out transaction. The IBM BUE wrote in an email that "this would be quite a nice deal to put this much business this far forward at a time when IBM desperately needs to show revenue growth." In addition, the IBM BUE had a direct incentive to close the deal. His annual bonus was based in part on the total revenue from the sales "price" for the new IBM equipment (which was artificially inflated to offset the purchase price for the Omron transaction). Specifically, almost 50% of the IBM BUE's bonus for 2000 was attributable to the Dollar General transaction.

3. IBM and Dollar General Finalize Contract Terms

After negotiating the terms of the financing and other arrangements over the course of a few weeks, IBM and Dollar General finalized the two-part transaction by agreements dated December 22, 2000. Under one agreement, IBM agreed to purchase 14,070 Omron registers from Dollar General for $11,098,672, with payment to be made to Dollar General no later than January 31, 2001 – just two days before the end of Dollar General's fiscal year 2000. On the same day, Dollar General signed a separate agreement committing the company to lease 4,224 new IBM registers for approximately $21 million. That purchase price was to be financed by IBM Credit Corporation and would be repaid by Dollar General over five years, starting in January 2001.

4. IBM "Buys" the Omron Registers

IBM and the IBM BUE understood that Dollar General needed to receive the check for the sale of the Omron registers by the end of January 2001 to achieve the desired accounting result. The written agreement also required that IBM make the payment to Dollar General no later than January 31, 2001. On January 17, 2001, the IBM BUE sent an internal email to several IBM employees seeking to have the check for the Omron registers issued. In the email, he stated: "It is critical that this check gets cut ASAP to Dollar General for $11,216,995. Their fiscal year ends 01/31/01 and this must be in house at DG."

Notably, the $11.2 million amount referenced in the IBM BUE's email includes both the purchase price of $11,098,672 and an additional $118,323 that IBM was paying to cover the cost of disposal of the very equipment that it was purchasing. Although various IBM personnel saw the check request and one individual noted that the whole transaction seemed "a little peculiar and may be worth asking . . . questions [about]," the check request was approved and the check was issued to Dollar General shortly before January 31, 2001, two days before the end of Dollar General's fiscal year 2000.

Despite the purchase agreement, almost two years later in late 2002, none of the Omron registers purportedly purchased by IBM had left Dollar General's custody, nor were they destroyed. They were stored in Dollar General distribution centers awaiting disposal.

5. IBM and Dollar General's Respective Accounting for the Transaction

Dollar General received significant accounting benefits from the Omron transaction. Dollar General utilized the Omron purchase payment from IBM to improperly reduce certain expenses for its fiscal year 2000, thereby inflating its reported pre-tax income. Specifically, Dollar General improperly reduced the loss on Omron registers accounted for as having been removed from service in 2000.

The Omron transaction also served to enable Dollar General to avoid addressing an unrelated accounting issue pertaining to the Omron equipment – specifically, the fact that Dollar General had not sufficiently depreciated the Omron equipment during fiscal year 2000. At the time Dollar General entered into the multi-year agreement with IBM to replace the Omron equipment, Dollar General should have reassessed the remaining useful lives of the Omron equipment and accelerated the depreciation on that equipment consistent with the equipment removal and replacement schedule. In the fourth quarter 2000, at the time Dollar General entered into the Omron transaction with IBM, Dollar General had not depreciated the Omron equipment sufficiently (by approximately $7.9 million) during fiscal year 2000. The Omron transaction, which removed the assets from the books, alleviated the need for Dollar General to face this problem. Utilizing the cash received from IBM for the Omron equipment, Dollar General instead minimized the loss on disposal of Omron registers and did not incur a substantial depreciation charge.

By improperly reducing expenses that Dollar General should have recognized, the net effect of Dollar General's accounting for the sham payment from IBM was to increase Dollar General's pretax income for fiscal 2000 by $7.1 million, or 6.5% of Dollar General's restated pretax fiscal year 2000 income.

IBM, in contrast, ultimately accounted for the transaction by netting out the impact of the "purchase" of Omron equipment. IBM treated the purchase price for the Omron registers as a trade-in credit against the full purchase price of the new IBM equipment. IBM, however, did have to undertake unusual journal entries in order to accomplish this task because the transactions were separately documented. Consequently, as the IBM BUE wrote in a December 21, 2000 email, the "[l]edger amount to IBM Retail Store Solutions" was the net of the full purchase price, less the Omron price, for a total of approximately $10.1 million. As structured, however, certain IBM employees received credit for the full $21 million purchase price for purposes of bonus calculations. Consequently, certain IBM employees, including the IBM BUE, received bonuses that were higher than they would have been but for the fraudulent Omron transaction.

D. IBM'S INACCURATE BOOKS AND RECORDS

As a result of numerous discrete incidents taking place in various IBM units, divisions, and wholly-owned subsidiaries in the United States, and in at least 23 other countries, IBM made at least $200 million in revenue recognition errors in its fiscal year 2000, and at least $377 million in revenue recognition errors in its fiscal year 2001.

At least $281 million of this revenue involved the use of side letters, a substantial portion of which were side letters in which IBM granted rights of return. For example, in December 2000, several executives, managers, and employees of IBM Retail Store Solutions (the same unit involved in the Omron transaction) and Business Partner units caused IBM to improperly recognize $9.3 million in revenue in connection with the sale of 22,680 printers to a business partner. Revenue recognition was improper at the time because, among other reasons, IBM Retail Store Solutions employees had granted a full right of return for the equipment in a side letter to the business partner.[3] This $9.3 million in improperly recognized revenue allowed the Retail Store Solutions unit to exceed its full-year sales target by $2 million.

At least $171 million of this revenue recognized in error for IBM's fiscal years 2000 and 2001 related to premature revenue recognition of product stored in warehouses not controlled by IBM's customers. At least $100 million of this amount related to IBM's Retail Store Solutions unit and its use of IBM-controlled warehouses to store merchandise that had not been shipped to the end-customer but for which IBM nonetheless recognized revenue.[4]

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3 The mere fact that a side letter was used to grant a right of return to a customer and that the right is termed a "full right" indicates a more-than-normal likelihood that the sale might be reversed and the product returned. In such a situation, the probability that the product will be returned and the amount of returns cannot be reasonably estimated, and thus the sale cannot be recognized. Financial Accounting Standard ("FAS") No. 48, Revenue Recognition When Right of Return Exists, includes, as a criterion for recognizing revenue when the right of return exists, that "the amount of future returns can be reasonably estimated."

4 SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, states, "The staff believes that revenue generally is realized or realizable and earned when . . . [among other criteria] delivery has occurred or services have been rendered." *See also* Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises (stating that "if a sale or cash receipt (or both) precedes…delivery…, revenues may be recognized as earned by production and delivery"). Under the circumstances in this case, it was improper for IBM to recognize revenue at a time when it had not actually delivered the product.

The revenue recognition errors were, in many cases, errors with respect to the timing of recognition as between quarters. In most cases, the revenue recognition errors were discovered and corrected by IBM in advance of the Commission's investigation.

E. LEGAL DISCUSSION

1. IBM Caused Dollar General's Fraud

Section 21C of the Exchange Act provides that the Commission may order any person who is or was a cause of a violation of any provision of the Exchange Act, due to an act or omission the person knew or should have known would contribute to the violation, to cease and desist from causing such violations. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder proscribe a variety of fraudulent practices in connection with the purchase or sale of securities. Violations of Section 10(b) and Rule 10b-5 occur when an issuer makes material misstatements or omissions in periodic reports filed with the Commission, including financial statements, and trading thereafter occurs in the issuer's securities. *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 860-862 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); *SEC v. Great American Indus.*, 407 F.2d 453 (2d Cir.), *cert. denied*, 395 U.S. 920 (1968).

The Supreme Court, in interpreting the securities laws, has held that a fact is material if there is a "substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the `total mix' of information made available." *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). Information regarding the financial condition of a company is presumptively material. *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). Even financial misstatements that are not large in magnitude may be material if they are made intentionally to manage a company's income, hide a failure to meet analysts' expectations or sustain an earnings trend. *See Ganino v. Citizens Utility Co.*, 228 F.3d 154, 166 (2d Cir. 2000).

Dollar General violated Section 10(b) and Rule 10b-5 thereunder by fraudulently overstating its fiscal year 2000 income with the benefit of the Omron transaction. IBM was a cause of Dollar General's violations because IBM knew or should have known that its creation of and participation in the Omron transaction to solve Dollar General's "book loss" problem would contribute to Dollar General's securities fraud. IBM knew the Omron purchase transaction was not a bona fide sale because the Omron equipment was worthless, would be destroyed, and that the purchase "price" was really a loan from IBM to Dollar General that would be repaid through the inflated price for IBM's new equipment. In addition, IBM knew explicitly that it was an accounting impact on Dollar General's earnings that was the obstacle in completing the transaction – and IBM agreed to participate in a transaction that would solve that accounting problem. By engaging in the transaction with Dollar General, IBM was a cause of Dollar General's fraud.

2. IBM Caused Dollar General's Books and Records and Reporting Violations

Section 13(a) of the Exchange Act requires issuers with securities registered under Section 12 of the Exchange Act to file with the Commission such information and documents as required to keep reasonably current the information and documents required to be included in or filed with an application or registration statement. The requirement that issuers file such information and documents necessarily embodies the requirement that such reports be true and correct. *See Great Sweet Grass Oils, Ltd.,* 37 S.E.C. 683, 684 n.1 (1957), *aff'd*, 256 F.2d 893 (D.C. Cir. 1958); *see also SEC v. IMC Int'l,* 384 F. Supp. 889, 893 (N.D. Tex. 1974) ("The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports."), *aff'd*, 505 F.2d 733 (5th Cir. 1974). Rule 13a-11 requires issuers to file current reports on Form 8-K. Rule 12b-20 further requires that such reports contain any further material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. Financial statements in Commission filings that do not comply with GAAP are presumed to be misleading. Regulation S-X, 17 C.F.R. § 210.4-01(a)(1). No showing of scienter is required to violate Section 13(a). *See SEC v. McNulty,* 137 F.3d 732, 740-741 (2d Cir. 1998). A person may be a cause of a non-scienter based violation through negligent conduct that contributes to the violation. *See KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002).

Dollar General violated Section 13(a) of the Exchange Act and Rules 13a-11 and 12b-20 thereunder by filing inaccurate Forms 8-K on January 23, 2001 and February 28, 2001 relating to Dollar General's fiscal 2000 earnings. These reports were inaccurate because they included overstated earnings as a result of the Omron transaction. IBM was a cause of Dollar General's violations because it knew or should have known that it was contributing to Dollar General's reporting of inaccurate financial statements by participating in the sham Omron transaction.

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Dollar General violated Section 13(b)(2)(A) by failing to make and keep books, records, and accounts, which accurately and fairly reflected the Omron transaction in reasonable detail. IBM was a cause of Dollar General's violations of Section 13(b)(2)(A) because it knew or should have known that it was contributing to Dollar General's participation in and inaccurate recording of the Omron transaction.

3. IBM Violated the Books and Records Provisions of the Securities Laws

IBM violated Section 13(b)(2)(A) by failing to make and keep books, records, and accounts, which accurately and fairly reflected transactions in reasonable detail, in IBM's own books, records, and accounts for its fiscal year 2000 and fiscal year 2001, as described in section D above.

F. UNDERTAKING

IBM undertakes, within ten (10) business days of the date of the issuance of this Order, to pay $7,000,000 to the Clerk of the United States District Court for the Middle District of Tennessee together with a cover letter specifying that this payment shall be deposited and joined to the funds currently held in *SEC v. Dollar General Corporation, et al.*, C.A. No. 3:05-0283. IBM has agreed to refer to this administrative proceeding in the cover letter and to transmit photocopies of such payment and letter to Kevin M. Loftus, Branch Chief, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549. IBM has agreed not to seek the return of any portion of its payment.

IV.

In determining to accept the Offer, the Commission considered the Undertaking in Section III. F. and remedial acts that were undertaken by Respondent.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent IBM's Offer.

Accordingly, it is hereby ORDERED that Respondent IBM cease and desist from committing or causing any violations and any future violations of Sections 10(b), 13(a), and 13(b)(2)(A) of the Exchange Act, and Rules 10b-5, 12b-20 and 13a-11 thereunder.

By the Commission.

Nancy M. Morris
Secretary