SEC Charges Dell and Senior Executives with Disclosure and Accounting Fraud

Company to Pay $100 Million Penalty, Michael Dell to Pay $4 Million Penalty

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Washington, D.C., July 22, 2010 — The Securities and Exchange Commission today charged Dell Inc. with failing to disclose material information to investors and using fraudulent accounting to make it falsely appear that the company was consistently meeting Wall Street earnings targets and reducing its operating expenses.

Additional Materials

- Litigation Release No. 21599
- SEC Complaint

The SEC alleges that Dell did not disclose to investors large exclusivity payments the company received from Intel Corporation to not use central processing units (CPUs) manufactured by Intel’s main rival. It was these payments rather than the company’s management and operations that allowed Dell to meet its earnings targets. After Intel cut these payments, Dell again misled investors by not disclosing the true reason behind the company’s decreased profitability.

The SEC charged Dell Chairman and CEO Michael Dell, former CEO Kevin Rollins, and former CFO James Schneider for their roles in the disclosure violations. The SEC charged Schneider, former regional Vice President of Finance Nicholas Dunning, and former Assistant Controller Leslie Jackson for their roles in the improper accounting.

Dell Inc. agreed to pay a $100 million penalty to settle the SEC’s charges. Michael Dell and Rollins each agreed to pay a $4 million penalty, and Schneider agreed to pay $3 million, to settle the SEC’s charges against them. Dunning and Jackson also agreed to settle the SEC’s charges.

“Accuracy and completeness are the touchstones of public company disclosure under the federal securities laws,” said Robert Khuzami, Director of the SEC’s Division of Enforcement. “Michael Dell and other senior Dell executives fell short of that standard repeatedly over many years, and today they are held accountable.”

Christopher Conte, Associate Director of the SEC’s Division of Enforcement, added, “Dell manipulated its accounting over an extended period to project financial results that the company wished it had achieved, but could not. Dell was only able to meet Wall Street targets consistently during this period by breaking the rules. The financial results that public companies communicate to the investing public must reflect reality.”
The SEC’s complaint, filed in federal district court in Washington, D.C., alleges that Dell Inc., Michael Dell, Rollins, and Schneider misrepresented the basis for the company’s ability to consistently meet or exceed consensus analyst EPS estimates from fiscal year 2002 through fiscal year 2006. Without the Intel payments, Dell would have missed the EPS consensus in every quarter during this period. The SEC’s complaint further alleges that Dell’s most senior former accounting personnel including Schneider, Dunning, and Jackson engaged in improper accounting by maintaining a series of “cookie jar” reserves that it used to cover shortfalls in operating results from FY 2002 to FY 2005. Dell’s fraudulent accounting made it appear that it was consistently meeting Wall Street earnings targets and reducing its operating expenses through the company’s management and operations.

According to the SEC’s complaint, Intel made exclusivity payments to Dell in order for Dell to not use CPUs manufactured by its rival — Advance Micro Devices, Inc. (AMD). These exclusivity payments grew from 10 percent of Dell’s operating income in FY 2003 to 38 percent in FY 2006, and peaked at 76 percent in the first quarter of FY 2007. The SEC alleges that Dell Inc., Michael Dell, Rollins, and Schneider failed to disclose the basis for the company’s sharp drop in its operating results in its second quarter of FY 2007 as Intel cut its payments after Dell announced its intention to begin using AMD CPUs. In dollar terms, the reduction in Intel exclusivity payments was equivalent to 75 percent of the decline in Dell’s operating income. Michael Dell, Rollins, and Schneider had been warned in the past that Intel would cut its funding if Dell added AMD as a vendor. Nevertheless, in Dell’s second quarter FY 2007 earnings call, they told investors that the sharp drop in the company’s operating results was attributable to Dell pricing too aggressively in the face of slowing demand and to component costs declining less than expected.

The SEC’s complaint further alleges that the reserve manipulations allowed Dell to materially misstate its earnings and its operating expenses as a percentage of revenue — an important financial metric that the company itself highlighted — for more than three years. The manipulations also enabled Dell to misstate materially the trend and amount of operating income of its EMEA segment, an important business unit that Dell also highlighted, from the third quarter of FY 2003 through the first quarter of FY 2005.

Without admitting or denying the SEC’s allegations, Dell Inc. consented to the entry of an order that permanently restrains and enjoins it from violation of 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 Securities Exchange Act of 1934 and Rules 10b-5, 12b-20, 13a-1, and 13a-13. Dell Inc. also agreed to enhance its Disclosure Review Committee and disclosure processes, including the retention of an independent consultant to recommend improvements to those processes and enhance training regarding the disclosure requirements of the federal securities laws.

Michael Dell and Rollins settled the SEC’s disclosure charges, without admiting or denying the SEC’s allegations, by each agreeing to pay the $4 million penalties and consenting to the entry of an order that permanently restrains and enjoins each of them from violating Sections 17(a)(2) and (3) of the Securities Act and from violating or aiding and abetting violations of other provisions of the federal securities laws.

Schneider consented to settle the disclosure and accounting fraud charges against him without admitting or denying the SEC’s allegations, and agreed to pay the $3 million penalty, disgorgement of $83,096, and prejudgment interest of $38,640. Dunning and Jackson consented to settle the SEC’s
improper accounting charges without admitting or denying the SEC’s allegations. Dunning agreed to pay a penalty of $50,000. In their settlement offers, Schneider, Dunning and Jackson consented to the issuance of administrative orders pursuant to Rule 102(e) of the Commission’s Rules of Practice, suspending each of them from appearing or practicing before the SEC as an accountant with the right to apply for reinstatement after five years for Schneider and three years for Dunning and Jackson.

The SEC’s investigation is continuing as to other individuals.

James Blenko, Shelby Hunt, Jonathan Jacobs, Ian Rupell, Robert Peak, Brian Palechek, and Jeffrey Anderson conducted the SEC’s investigation in this matter.

The SEC acknowledges the assistance of the Federal Trade Commission in this investigation.

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