

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 02-60131-CIV-Graham/Garber

NIGHT BOX
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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

v. :

PATRICK O. WHEELER,
STEVEN S. GALLERS,¹
ROBERT L. CARBERRY,

Defendants. :

FIRST AMENDED COMPLAINT

Plaintiff Securities and Exchange Commission (the "SEC") alleges:

SUMMARY

1. This action stems from fraudulent accounting practices by CyberGuard Corporation ("CyberGuard"), a publicly-traded computer network security systems manufacturer headquartered in Fort Lauderdale, Florida, during its 1997 and 1998 fiscal years.

2. Following a corporate restructuring at the end of its 1996 fiscal year, the company changed its name from Harris Computer Systems Corporation ("HCSC") to CyberGuard.

3. During its 1997 and 1998 fiscal years, CyberGuard engaged in a widespread scheme to materially inflate revenue by improperly recognizing revenue on contingent, backdated, incomplete, fictitious, and inadequately documented sales transactions.

¹ This matter has been settled as to defendants Gallers and Carberry, and charges as to them no longer appear in this First Amended Complaint.

4. During its audit of CyberGuard's 1998 fiscal year financial statements, in August 1998, CyberGuard's outside auditors uncovered information about certain sales transactions that CyberGuard improperly reported as revenue in previous fiscal quarters. Shortly after informing CyberGuard's management about these transactions, the outside auditors resigned.

5. On August 24, 1998, CyberGuard publicly announced the resignation of its outside auditors, that it had suspended its Chief Executive Officer ("CEO") and Chairman of the company's Board of Directors, along with its Chief Financial Officer ("CFO") at that time, and that it would be restating its financial results for the third quarter of its 1998 fiscal year.

6. On the day of the August 24, 1998 public announcement, the price of CyberGuard's common stock, which at the time traded on the NASDAQ National Market, fell approximately 70 percent. In January 1999, NASDAQ de-listed CyberGuard's common stock because the company failed to file its Form 10-K for its 1998 fiscal year and its Form 10-Q for the first quarter of its 1999 fiscal year. CyberGuard's stock now trades on the American Stock Exchange.

7. On August 31, 1999, CyberGuard restated its financial results for its 1997 fiscal year, including all interim quarters, and for the first three quarters of its 1998 fiscal year. Among other things, CyberGuard's restatement corrected numerous improperly recognized sales transactions.

8. By engaging in the transactions, acts, omissions, practices, and courses of business alleged herein, defendant Patrick O. Wheeler (CyberGuard's former CFO and Vice President of North American Sales, and its current Vice President of Business Development), directly or indirectly, violated the antifraud, books-and-records, and internal controls provisions of the federal securities laws. Wheeler also, directly or indirectly, made materially false and

misleading statements, and omitted to state material facts, to CyberGuard's outside auditors in violation of the federal securities laws.

JURISDICTION

9. Defendant Wheeler, directly and indirectly, has engaged in, and unless restrained and enjoined by this Court will continue to engage in, transactions, acts, practices, and courses of business that violate the following provisions of the federal securities laws:

(a) Securities Exchange Act of 1934 ("Exchange Act") Section 10(b) [15 U.S.C. § 78(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5];

(b) Exchange Act Section 13(b)(5) [15 U.S.C. § 78m(b)(5)] and Exchange Act Rule 13b2-1 [17 C.F.R. § 240.13b2-1]; and

(c) Exchange Act Rule 13b2-2 [17 C.F.R. § 240.13b2-2].

10. The SEC seeks a judgment that would permanently enjoin defendant Wheeler from future violations of the securities laws and brings this action pursuant to Exchange Act Sections 21(d) and 21(e). [15 U.S.C. §§ 78u(d) and 78u(e)]. The SEC also seeks an order, pursuant to Exchange Act Section 21(d)(2) [15 U.S.C. § 78u(d)(2)], that would permanently bar Wheeler from acting as an officer or director of an issuer that has a class of securities registered with the SEC pursuant to Exchange Act Section 12 [15 U.S.C. § 78] or that is required to file reports with the SEC pursuant to Exchange Act Section 15(d) [15 U.S.C. § 78o(d)]. Further, the SEC seeks civil penalties against defendant Wheeler pursuant to Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)].

11. This Court has jurisdiction over this action pursuant to Exchange Act Section 27 [15 U.S.C. § 78aa]. Certain of the transactions, acts, omissions, practices, and courses of business

constituting the violations of law alleged herein occurred within this judicial district. Venue lies in this Court pursuant to Section 27 of the Exchange Act.

12. In connection with the transactions, acts, omissions, practices, and courses of business described in this Complaint, defendant Wheeler, directly and indirectly, used the means or instrumentalities of interstate commerce, or of the mails, or of the facilities of a national securities exchange.

THE DEFENDANT

13. Patrick O. Wheeler, age 44, resides in Akron, Ohio, and was CyberGuard's CFO and Vice President of Finance from June 30, 1996 until November 1997. Additionally, in July 1997, Wheeler was appointed CyberGuard's Vice President of North American Sales, a position he held until June 30, 1998. Wheeler has been employed as CyberGuard's Vice President of Business Development from July 1, 1998 to the present.

RELATED ENTITY

14. CyberGuard is a Florida corporation with its principal executive offices in Fort Lauderdale, Florida. Formerly named Harris Computer Systems Corporation, the company changed its name to CyberGuard following a corporate restructuring on or about June 30, 1996. CyberGuard develops and sells commercial network security products designed to prevent unauthorized users from accessing data on computer networks. During the relevant period, CyberGuard's fiscal year ended June 30. During the relevant period, CyberGuard's common stock was registered with the Commission pursuant to Exchange Act Section 12(g) and listed on the NASDAQ National Market. Under the requirements of the Exchange Act, CyberGuard was required to, and did, file with the SEC quarterly reports (Form 10-Qs) and annual reports (Form 10-Ks) that contained financial statements.

FACTS

15. During its 1997 and 1998 fiscal years CyberGuard improperly recognized revenue on numerous contingent, backdated, incomplete, fictitious, and inadequately documented sales transactions. Based on this misconduct, CyberGuard materially overstated its reported revenues in its quarterly and annual reports for its 1997 fiscal year and in its quarterly reports for the first three quarters of its 1998 fiscal year.

16. Wheeler knew, or was reckless in not knowing, that as a result of his direct or indirect acts and omissions regarding revenue recognition, CyberGuard's reported revenues would be materially misstated. Wheeler also knew or was reckless in not knowing that he circumvented CyberGuard's existing internal accounting controls and/or failed to implement an effective system of internal accounting controls, and falsified CyberGuard's books, records, and accounts. Further, Wheeler, while an officer of CyberGuard, directly or indirectly, made or caused to be made materially false and misleading statements, or omitted to state or caused another person to omit to state, material facts necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, to accountants in connection with an audit of CyberGuard's financial statements required to be filed with the SEC.

17. Wheeler knew, or was reckless in not knowing, that CyberGuard often improperly recognized revenue in a manner that was not in conformity with generally accepted accounting principles ("GAAP") or with CyberGuard's publicly stated revenue recognition policy. Wheeler also knew, or was reckless in not knowing, that CyberGuard materially misstated its reported revenues in its filings with the SEC during its 1997 fiscal year, and in quarters during its 1998

fiscal year. Nevertheless, Wheeler signed CyberGuard's Form 10-Qs for its fiscal quarters ended September 30, 1996, December 31, 1996, and March 31, 1997, and CyberGuard's Form 10-K for the 1997 fiscal year. By his acts and omissions, Wheeler also directly or indirectly caused CyberGuard to misstate its reported revenues in the financial statements it filed with the SEC in its 1997 and 1998 fiscal years.

18. Wheeler, while he was CFO of CyberGuard, was responsible for both implementing a system of internal accounting controls that would ensure that CyberGuard's books, records, and accounts were not falsified, and for ensuring that any system of internal accounting controls was not circumvented. Wheeler not only failed in these responsibilities, but both while he was CFO and when he later was in charge of North American sales, he engaged in actions that caused CyberGuard's books, records, and accounts to be false and that materially misstated CyberGuard's revenues. CyberGuard and its auditors later created charts identifying numerous improperly recognized transactions; these improperly recognized transactions were subsequently reversed in CyberGuard's August 1999 restatement of its 1997 and 1998 fiscal year revenues.

19. While CFO, Wheeler became aware of some of the improperly recognized transactions through his review of internal CyberGuard accounts receivable collections memoranda. These memoranda reflected efforts by CyberGuard's accounting staff to collect outstanding payments from customers on sales transactions recognized as revenue in previous fiscal quarters. As set forth in these memoranda, certain of these sales transactions were based on material contingencies, including so-called "sell-through" agreements that made the customer's obligation to pay CyberGuard contingent on the customer's re-sale of CyberGuard's products to an end-user.

20. Under GAAP, specifically, Statement of Position (“SOP”) 91-1, it was improper to recognize revenue on these contingent sales. SOP 91-1 provides that a sale may not be recognized as revenue until it is final and free from material contingency. It was also improper to recognize revenue on these transactions under CyberGuard’s publicly stated revenue recognition policy, as set forth in the company’s 1997 fiscal year annual financial statements, which adopted the guidelines set forth in SOP 91-1.

21. Despite knowing, or being reckless in not knowing, about the improperly recognized contingent sales identified in these accounts receivable collections memoranda, Wheeler failed to take adequate corrective action regarding certain of these transactions. As such, Wheeler knew, or was reckless in not knowing, that CyberGuard’s reported revenues were materially misstated. Wheeler also knowingly failed to implement an effective system of internal controls that would adequately prevent contingent sales from being improperly recognized in the future.

22. While CFO, Wheeler also maintained a “debooking schedule,” to identify and track certain contingent transactions that he knew, or was reckless in not knowing, CyberGuard had improperly recognized as revenue in previous fiscal quarters. By his debooking schedule, Wheeler selectively subtracted the revenue improperly recognized on certain transactions in earlier reporting periods from the revenue recognized in later reporting periods, instead of reversing the revenue in the quarter in which it was improperly recognized in conformity with GAAP, and implementing internal controls sufficient to prevent improper revenue recognition from occurring again. Wheeler knew, or was reckless in not knowing, that his method of selectively debooking improperly recognized sales was inconsistent with GAAP, and that CyberGuard’s reported revenues were thus materially misstated.

23. Wheeler did not “debook” certain of the transactions that he knew, or was reckless in not knowing, were improperly recognized in earlier fiscal quarters. Wheeler allowed these improperly recognized transactions to go uncorrected. Wheeler knew, or was reckless in not knowing, that by failing to take adequate corrective action regarding these improperly recognized transactions, CyberGuard’s reported revenues would thus be materially misstated.

24. Wheeler, as CFO, also prepared and signed CyberGuard’s 1997 fiscal year quarterly and annual filings with the SEC, despite knowing, or being reckless in not knowing, that CyberGuard’s reported revenues were materially misstated as a result of numerous improperly recognized sales transactions and his acts and omissions in selectively debooking certain contingent transactions.

25. Despite knowing, or being reckless in not knowing, that numerous contingent transactions were improperly recognized during CyberGuard’s 1997 fiscal year, and that these improperly recognized transactions would cause CyberGuard to materially misstate its reported revenues in its 1997 fiscal-year Form 10-K filed with the SEC, Wheeler signed CyberGuard’s September 29, 1997 management representation letter to CyberGuard’s outside auditors, made in connection with its 1997 audit. By this letter, Wheeler falsely represented that he was not aware of any contingent terms or agreements that would impact CyberGuard’s ability to recognize revenue on any sales transaction recognized during the 1997 fiscal year.

26. Wheeler, while serving in a dual capacity as CyberGuard’s CFO and Vice President of North American Sales, also executed an agreement with a customer in July 1997 that made all of CyberGuard’s future sales to the customer subject to a material contingency; that customer later entered into transactions under that agreement that were improperly recorded as

revenue during CyberGuard's 1998 fiscal year. This resulted in a material overstatement of quarterly revenues.

27. Wheeler, as CyberGuard's Vice President of North American Sales during the company's 1998 fiscal year, also drafted an April 7, 1998 letter to a customer memorializing an agreement that the customer did not have to pay CyberGuard until it resold CyberGuard's products to an end-user. CyberGuard recognized the entire \$103,817 transaction as revenue in the fiscal quarter ended March 31, 1998, despite the existence of this material contingency, and even though CyberGuard did not ship products to the customer until fifteen days after the close of the quarter. Wheeler knew, or was reckless in not knowing, that CyberGuard's reported revenues in the fiscal quarter ended March 31, 1998 would be materially overstated as a result of his acts or omissions.

28. Wheeler also knew, or was reckless in not knowing, that other transactions subject to his oversight as Vice President of North American Sales were improperly recognized as revenue during CyberGuard's 1998 fiscal year, including, among others, transactions in which documents were backdated to permit the improper recognition of revenue.

29. During its audit of CyberGuard's 1998 fiscal year financial statements, CyberGuard's auditors asked Wheeler about the existence of side agreements and he failed to disclose all the contingent transactions he knew about.

30. Based on his conduct while Vice President of North American Sales, Wheeler knowingly circumvented CyberGuard's internal accounting controls, falsified CyberGuard's books, records, and accounts, and directly or indirectly, made or caused to be made materially false and misleading statements, or omitted to state or caused another person to omit to state, material facts necessary in order to make the statements made, in light of the circumstances under

which such statements were made, not misleading, to accountants in connection with an audit of CyberGuard's financial statements required to be filed with the SEC.

FIRST CLAIM

(Exchange Act Section 10(b) and Exchange Act Rule 10b-5)

31. Paragraphs 1 through 30 are realleged and incorporated by reference.
32. By engaging in the foregoing conduct, Wheeler violated Exchange Act Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM

(Exchange Act Section 13(b)(5) and Exchange Act Rule 13b2-1)

33. Paragraphs 1 through 30 are realleged and incorporated by reference.
- By engaging in the foregoing conduct, Wheeler violated Exchange Act Section 13(b)(5) [15 U.S.C. § 78m(b)(5)] and Exchange Act Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1].

THIRD CLAIM

(Exchange Act Rule 13b2-2)

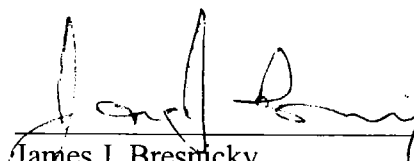
34. Paragraphs 1 through 30 are hereby realleged and incorporated by reference.
35. Wheeler while an officer of CyberGuard, directly or indirectly, made or caused to be made materially false and misleading statements, or omitted to state or caused another person to omit to state material facts necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with an audit of CyberGuard's financial statements required to be filed with the SEC.
36. By reason of the foregoing, Wheeler violated Exchange Act Rule 13b2-2 [17 C.F.R. § 240.13b2-2].

RELIEF REQUESTED

WHEREFORE, the SEC respectfully requests that this Court enter a judgment that:

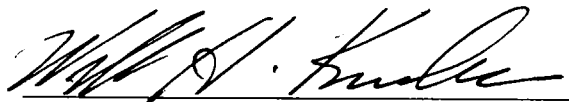
- (i) permanently enjoins Wheeler from violating Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5];
- (ii) permanently enjoins Wheeler from violating Exchange Act Section 13(b)(5) [15 U.S.C. § 78m(b)(5)] and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1];
- (iii) permanently enjoins Wheeler from violating Rule 13b2-2 of the Exchange Act [17 C.F.R. § 240.13b2-2];
- (iv) permanently prohibits Wheeler, pursuant to Exchange Act Section 21(d)(2) [15 U.S.C. § 78u(d)(2)], from acting as an officer or director of an issuer that has a class of securities registered with the SEC pursuant to Exchange Section 12 [15 U.S.C. § 78l] or that is required to file reports with the SEC pursuant to Exchange Act Section 15(d) [15 U.S.C. § 78o(d)];
- (v) orders Wheeler to pay appropriate civil penalties pursuant to Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)]; and
- (vi) grants such other relief as the Court deems just or appropriate.

Dated: November 15, 2002



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