

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59903 / May 12, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2968 / May 12, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13466

In the Matter of

INGRAM MICRO INC.,

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTION
21C OF THE SECURITIES EXCHANGE ACT
OF 1934, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST ORDER**

I.

The 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 Ingram Micro Inc. (“Ingram Micro” 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 Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

These proceedings arise out of the business dealings between Ingram Micro and McAfee, Inc., formerly known as Network Associates, Inc. (referred to herein as "McAfee") during the period from the second quarter of 1998 through the third quarter of 2000 when McAfee was engaged in a massive financial fraud. During that period, McAfee overstated its revenues and earnings by stuffing its distribution channel at Ingram Micro with levels of inventory far in excess of any reasonable expectation of sales to end users while misreporting its revenues from these sales to their distributors.² For its part, Ingram Micro, McAfee's largest customer and greatest single source of revenue, engaged in a variety of highly irregular transactions with McAfee, many of them lacking in economic substance, which enabled McAfee to continue overselling its products to Ingram Micro. In the course of its business dealings with McAfee, Ingram Micro failed to keep accurate books and records and failed to devise and maintain an adequate system of internal controls. Ingram Micro was compensated by McAfee for engaging in these irregular transactions through the payment of millions of dollars of unearned profits, cash payments, and improperly recorded excess inventory fees.

Respondent

1. Respondent Ingram Micro Inc. is a Delaware corporation with its principal office in Santa Ana, California. Ingram Micro is a technology distribution company. Ingram Micro's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange under the symbol "IM."

Other Relevant Entity

2. McAfee, Inc. is a Delaware corporation with its principal office in Santa Clara, California. McAfee is a manufacturer of computer programs focusing on network security, anti-virus, and network management products. McAfee's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange under the symbol "MFE." Prior to June 30, 2004, McAfee was known as Network Associates, Inc.

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.

² On January 4, 2006, the Commission filed a settled civil injunctive action against McAfee, Inc., in which McAfee agreed to be permanently enjoined from violations of the anti-fraud, books and records, and internal controls provisions of the Exchange Act. McAfee also consented to the entry of a permanent injunction and the payment of a \$50 million civil penalty. *SEC v. McAfee, Inc.*, Civil Action No. 06-009 (PJH) (N.D. Cal.); Lit. Rel. No. 19520 (Jan. 4, 2006).

Facts

Background

3. Between 1998 and 2000, McAfee overstated its revenues by \$622 million in order to meet revenue and earnings targets, and understated its cumulative net losses by \$353 million. As the Commission alleged in its January 2006 complaint:

McAfee stuffed its distribution channel and improperly recorded hundreds of millions of dollars of revenue on sales transactions with distributors in violation of the antifraud and other provisions of the federal securities laws. In a fraudulent scheme to oversell its products and immediately record the revenue from those transactions, McAfee secretly gave its distributors substantial cash payments, price discounts, rebates, and other concessions as inducements to continue buying, as well as to not return, McAfee products that the distributors had no reasonable expectation of selling to customers.

In addition, the Commission's complaint alleged that McAfee concealed its scheme by "falsely record[ing] in its books and records certain of the payments and concessions to distributors," and that McAfee "misled investors by filing with the Commission materially false and misleading annual and quarterly reports and securities registration statements." As a result, McAfee violated antifraud, issuer reporting, books and records, and internal controls provisions of the securities laws. In settlement, McAfee agreed to a permanent injunction and paid a \$50 million civil penalty.

4. During the period of McAfee's misconduct, Ingram Micro was McAfee's largest distributor and single most significant source of sales.³ In 1998, McAfee changed its accounting method to the "sell-in" model, which allowed it to recognize revenue upon the sale of products to distributors like Ingram Micro, instead of deferring revenue recognition until its products had been sold to end-users. Taking advantage of the change to sell-in accounting, McAfee embarked on a scheme to meet quarterly revenue targets through "channel stuffing" – that is, by pushing excessive amounts of products to its distributors, particularly Ingram Micro. End-of-quarter sales to Ingram Micro (memorialized in so-called "buy-in agreements" that were negotiated quarterly between the two companies), in particular, had a significant impact on McAfee's reported revenues and its ability to meet market expectations.

5. Ingram Micro's written contract with McAfee expressly limited Ingram Micro's ability to return products. However, McAfee and Ingram Micro had an unwritten understanding that Ingram Micro had an unlimited right to return unsold products to McAfee. During this period, few vendors extended unlimited return rights to their distributors, but McAfee offered unlimited return rights to Ingram Micro in order to induce Ingram Micro to purchase additional product.

³ In the year 2000, for example, sales to Ingram Micro accounted for approximately twenty percent of McAfee's net revenue.

6. Starting in the second quarter of 1998, Ingram Micro's Product Management Group realized that McAfee was willing to provide deep discounts and off-contract enhancements to Ingram Micro in the quarterly "buy-in agreements." As a result, Ingram Micro altered its buying practices and began ordering extraordinarily large amounts of McAfee products, far in excess of the amounts that Ingram Micro reasonably expected to sell. Ingram Micro began to realize significantly higher profit margins in return for taking on excess inventory from McAfee, which consisted mainly of software licenses. In return for Ingram Micro's increased purchases, McAfee provided various forms of compensation – in the form of cash payments, price concessions, and allowances for unlimited returns – that made Ingram Micro's role in McAfee's channel-stuffing scheme highly profitable and low-risk.

7. The McAfee account rapidly became one of Ingram Micro's most profitable vendor relationships, despite the fact that McAfee represented a small percentage of Ingram Micro's total sales. Ingram Micro obtained extraordinary profit margins on its business with McAfee compared to its other vendors because, unlike other vendors, McAfee routinely provided Ingram Micro with nonrefundable discounts on Ingram Micro's orders of McAfee products. Ingram Micro retained these discounts regardless of whether it later sold or returned the purchased products. In addition, McAfee even paid Ingram Micro a profit margin on products that McAfee itself later re-sold through a McAfee subsidiary. Consequently, McAfee paid Ingram Micro millions of dollars to take and hold products that Ingram Micro did not need and was not selling. The combination of an unlimited right of return and payment of nonrefundable discounts created a mutually beneficial and profitable relationship between the companies. Ingram Micro gave McAfee a ready outlet for large volumes of its products, a substantial portion of which ultimately were not sold and were returned to McAfee, and McAfee used these sales to inflate its reported revenue. For its part, Ingram Micro had a cash-rich vendor willing to make extraordinary payments and concessions that enabled Ingram Micro's Product Management Group to post greater profit margins for its software segment, and thereby boost the company's overall performance.

Ingram Micro Ignored Its Internal Inventory Goals and Held Excess McAfee Product

8. During the relevant period, Ingram Micro's internal inventory management goal was to carry no more than eight weeks worth of inventory from any vendor. Ingram Micro monitored its levels of owned inventory on a monthly basis. From the second quarter of 1998 through 2000, in order to take advantage of McAfee's willingness to pay Ingram Micro to buy ever-increasing levels of unneeded products, Ingram Micro disregarded its inventory goals and held excessive amounts of unneeded McAfee products, maintaining inventory levels far in excess of the amount it reasonably expected to sell. By early 2000, Ingram Micro carried as much as *twenty-two months worth* of inventory of McAfee software licenses (that is, the amount of inventory that Ingram Micro ordinarily would expect to sell over the course of twenty-two months). Instead of exercising its unwritten right to return products to McAfee in order to reduce the inventory, Ingram Micro continued purchasing McAfee product in 2000 in order to take advantage of the extraordinary discounts and cash payments offered to Ingram Micro by McAfee as an inducement to purchase additional products.

Ingram Micro Misrecorded on its Books and Records Round-Trip Transactions
With McAfee That Were Not Detected by Ingram Micro's Internal Controls

9. During the relevant period, Ingram Micro and McAfee also engaged in various circular transactions that were lacking in economic substance and were designed solely to inflate McAfee's reported revenues. Ingram Micro profited from these transactions by receiving unearned compensation on sales that it did not originate.

10. From June 1998 through June 2000, McAfee bought back tens of millions of dollars worth of its own products from Ingram Micro – while granting Ingram Micro a significantly higher than normal profit margin – in order to avoid costly direct returns that would have negatively impacted McAfee's revenues. McAfee carried out this subterfuge by using a subsidiary called "Net Tools" to repurchase approximately \$45.5 million of inventory it had sold to Ingram Micro. In order to avoid accepting returns directly from Ingram Micro, McAfee acted as a reseller and instructed Ingram Micro to ship the products to buyers identified by McAfee. McAfee reimbursed Ingram Micro for the shipping costs and paid an inflated profit margin to Ingram Micro, even though Ingram Micro had done nothing to bring about the sale of the products. These transactions reduced Ingram Micro's inventory and enabled Ingram Micro to dispose of excess McAfee products at a profit, without directly returning the product to McAfee. McAfee's use of Net Tools as a means for reducing excess inventory held by Ingram Micro was a subject of quarterly buy-in negotiations between McAfee and Ingram Micro concerning the amount of additional McAfee products that Ingram Micro would agree to buy and the terms of those quarterly buy-in transactions. Ingram Micro knew or should have known that McAfee was buying back its own products through Net Tools. Ingram Micro dedicated no selling efforts to these transactions – no sales executive was ever assigned by Ingram Micro to the Net Tools account. Nonetheless, Ingram Micro earned a high profit margin of approximately thirteen percent on its sales to Net Tools, far in excess of its average profit margin of two to three percent during that period.

11. In seven consecutive quarters beginning in 1998, Ingram Micro and McAfee took advantage of asymmetries in the dates on which the companies' respective quarters ended.⁴ Before the end of McAfee's quarter, Ingram Micro would agree to purchase millions of dollars of McAfee products that it did not need to meet its inventory requirements or sales goals. Within days, however, after McAfee's quarter closed, but before Ingram Micro's quarter had ended, Ingram Micro returned equivalent product to McAfee to avoid reporting the inventory on its quarter-end financial statements. McAfee exploited the timing of the product sales and returns that occurred during the gaps between the companies' quarter-ends ("gap days") to record revenues in one quarter while deferring recording the related returns until the following quarter. McAfee compensated Ingram Micro for participating in these patently-irregular and nonsubstantive gap day transactions by paying Ingram Micro non-refundable volume-based discounts on the purchases. McAfee, in turn, engaged in the sham gap day transactions and deferred accounting for the product

⁴ Ingram Micro's fiscal calendar was organized into four quarters of thirteen weeks, while McAfee's fiscal calendar used the more traditional quarters that ended on the last day of every third month. Consequently, McAfee's fiscal quarter would, at times, end one or more days before Ingram Micro's fiscal quarter ended.

returns until the following quarter, in order to create the appearance that it had met its quarterly sales goals and to inflate its revenue. In total, more than \$115 million worth of McAfee products was purchased and returned by Ingram Micro in such gap day transactions.⁵

12. Ingram Micro's participation in the quarter-end transactions was attributable, in part, to a failure to devise and maintain an adequate system of internal controls. Although Ingram Micro's Product Management Group approved the amount and timing of the purchases from and returns to McAfee, properly functioning internal accounting controls would have alerted senior management to the nature, timing, and extent of the nonsubstantive purchase-and-return transactions. Ingram Micro's books and records did not fairly and accurately reflect the true nature of these transactions.

13. In the second quarter of 1999, McAfee arranged sham sales of approximately \$11 million worth of products by Ingram Micro to certain customers as another means of bolstering McAfee's reported revenues. To execute these transactions, Ingram Micro needed to make a special purchase of McAfee product, which it then delivered to the customers that had been identified by McAfee. McAfee recorded revenue immediately upon sale of the additional product to Ingram Micro. The products later were returned to Ingram Micro by the customers. McAfee paid Ingram Micro more than \$600,000 as a purported profit on the sales, even though Ingram Micro was merely the conduit for the delivery and subsequent return of the products. When Ingram Micro sought to deduct from its accounts payable to McAfee the cost of the goods that it had specially purchased for these transactions, which would have lowered McAfee's revenues in the quarter, McAfee sent Ingram Micro a cash payment equal to the cost of the goods and a profit

⁵ Ingram Micro and McAfee also engaged in other similar transactions that were designed to enable McAfee to record revenue from additional sales to Ingram Micro prior to the end of its quarter, while deferring when Ingram Micro would receive the product and, ultimately, allowing Ingram Micro to return to McAfee in a subsequent quarter a substantial portion of the product that Ingram Micro purchased in such transactions. Ingram Micro and McAfee structured certain quarterly buy-in deals so that McAfee could record revenue from such sales during its quarter, but the purchased product would not "arrive" in Ingram Micro's inventory until after Ingram Micro's quarter had ended. At various times during the relevant period, Ingram Micro insisted on such "slow-boating" arrangements as a condition of its agreement to purchase product from McAfee. McAfee's agreement not to ship the product until after Ingram Micro's quarter had ended enabled Ingram Micro to avoid recording the product in its inventory for its quarterly reports. However, the agreements were contrivances because the products at issue were, for the most part, software licenses and not tangible inventory that needed to be shipped or otherwise physically delivered. McAfee made rebate payments and other concessions in order to induce Ingram Micro to participate in such transactions.

Between the first quarter of 1999 and the fourth quarter of 2000, Ingram Micro placed at least \$188.5 million in purchase orders that were designated for shipment after the close of Ingram Micro's quarter. Of this amount, Ingram Micro received about \$172 million in McAfee products after the quarter in which the buy-in deal was made. Of the \$172 million in products that were received after the quarter of the buy-in deal, Ingram Micro returned approximately \$145 million worth to McAfee. These returns effectively completed round-trip transactions that enabled McAfee to inflate its reported financial results. For its part, Ingram Micro received millions of dollars in payments and other concessions from McAfee that, as discussed above, were not contingent on Ingram Micro actually selling the products.

margin of more than \$600,000, in order to avoid having to accept a return. Ingram Micro inaccurately recorded the transaction as a sale in its own financial records.

Ingram Micro Was Paid To Not Return McAfee Products

14. McAfee made disguised payments to induce Ingram Micro to refrain from exercising its unlimited right to return unsold inventory to McAfee. On at least four occasions, Ingram Micro requested and received payments for holding “excess inventory,” even though the inventory consisted mainly of electronic software licenses represented by bar codes kept in binders that occupied little warehouse space and, as a result, entailed virtually no storage expense for Ingram Micro. The excess inventory fees were calculated as a percentage of the value of Ingram Micro’s owned inventory of McAfee products.

15. As Ingram Micro’s inventory of McAfee products increased, so did the size of its requests for excess inventory payments, resulting in Ingram Micro obtaining both volume-based discounts at the time of the buy-in agreements, and additional holding fees on the same unsold products for agreeing not to return them to McAfee. Near the end of the first quarter of 2000, Ingram Micro determined that it held \$54 million worth of excess McAfee inventory. To forestall a return of some or all of this inventory, senior McAfee officials offered to discount the amount that Ingram Micro owed McAfee by two percent of the value of the excess inventory – or approximately \$1.1 million -- as a further inducement for Ingram Micro to continue holding the excess inventory and purchasing additional inventory in the following quarter. This discount was memorialized in a side letter dated March 8, 2000. Subsequently, Ingram Micro not only did not return the excess McAfee inventory, but, on March 24, 2000, entered into a new agreement to purchase approximately \$31.4 million worth of additional McAfee products. Ingram Micro also requested excess inventory fees in the second and third quarters of 2000, similarly calculated as a percentage of the value of the excess stock that Ingram Micro held in its inventory. In June 2000, Ingram Micro received approximately \$2.5 million to continue holding excess inventory, and in the third quarter, Ingram Micro was paid approximately \$3.8 million in excess inventory payments.

Ingram Micro Misrecorded Excess Inventory Payments as Early Pay Discounts

16. The excess inventory fees negotiated by Ingram Micro for the second and third quarters of 2000 were characterized on Ingram Micro’s books in a manner designed to meet quarterly financial targets. In both quarters, Ingram Micro asked McAfee to recharacterize the excess inventory payments as “early pay” discounts, or discounts that would have been earned if Ingram Micro had paid on its account with McAfee earlier than required under their contract. These recharacterizations did not accurately reflect the substance of the McAfee payments. Under Ingram Micro’s accounting policies, had the \$6.3 million of fees been associated with its inventory, such as an “excess inventory” payment, then Ingram Micro would have been unable to recognize the full amount of the fees in the quarters in which they were received, pending the disposition of the inventory associated with the fees. After McAfee agreed to recharacterize the fees as “early pay discounts,” Ingram Micro recognized the fees into income in the quarters they were received, and did not amortize them over time, as required by its accounting policies. In these transactions, Ingram Micro solicited and obtained documentation from McAfee that did not

accurately reflect the substance of the McAfee payments. As a result, Ingram Micro inaccurately recorded those transactions on its books and records as “early pay” discounts, rather than inventory-related payments.

Ingram Micro Accepted and Misrecorded Mischaracterized Payments From McAfee

17. McAfee often mischaracterized in its communications with Ingram Micro the purpose and nature of the payments that it was making to Ingram Micro as inducements for Ingram Micro to hold excess inventory and purchase additional inventory. From September 1999 through October 2000, McAfee mischaracterized in correspondence and communications with Ingram Micro the actual purpose of payments totaling at least \$59.5 million. McAfee relied upon the misleading descriptions to disguise and justify its own improper accounting for the discounts and concessions it paid to Ingram Micro. Although Ingram Micro was aware of the mischaracterizations as well as the actual purpose for the payments from McAfee, Ingram Micro accepted the payments and typically recorded them on its books and records with different explanations or designations that comported with Ingram Micro’s understanding of the actual purpose of the payments, and not the explanation that had been made by McAfee in its correspondence. A properly functioning system of internal controls would have alerted senior management to these discrepancies.

18. In one instance, on September 30, 1999, McAfee wired a \$16 million cash payment to Ingram Micro in order to keep Ingram Micro from reducing its payment on a pending invoice by a corresponding amount. Ingram Micro initially classified the payment as an “unapplied amount for future amounts due,” but later, Ingram Micro applied the \$16 million cash payment to offset nearly \$16 million in planned returns, rather than deducting that amount from a payment to McAfee for product purchases. At the end of the quarter, Ingram Micro paid McAfee in full the invoiced amounts for purchased product, in effect returning the \$16 million to McAfee. Ingram Micro’s books and records, and internal controls, never properly reflected the purpose of the \$16 million payment, which was to prevent Ingram Micro from returning products and reducing its accounts payable to McAfee.

19. Similarly, in November 1999, McAfee sent Ingram Micro a memorandum in which it outlined a plan to pay Ingram Micro \$21 million for discounts, fees, and concessions that had been negotiated in prior quarterly buy-in transactions. On November 17, 1999, McAfee delivered eight payments totaling over \$21 million to Ingram Micro in eight separate wire transfers. At the same time, McAfee also sent Ingram Micro eight cover letters, each dated November 17, 1999, characterizing the payments as reimbursement for expenses such as “marketing fund rebates and other promotional programs” rather than discounts, fees, and concessions, and attributing the payments to quarters other than those for which the payments actually were being made.

20. McAfee’s November 1999 memorandum also revealed that one purpose of the payments was to create a misleading accounts receivable balance that Ingram Micro could confirm to McAfee’s outside accountants. In the memorandum, McAfee asked Ingram Micro to confirm to McAfee’s outside accountants that Ingram Micro owed McAfee approximately \$40 million. However, at the time, Ingram Micro could not truthfully confirm a \$40 million balance because

Ingram Micro's records reflected an account payable of only about \$19 million, after deducting the \$21 million in discounts and other amounts that McAfee previously had agreed to pay to Ingram Micro for purchasing additional products. In the memorandum, McAfee proposed that it would pay Ingram Micro \$21 million in order to offset the \$21 million in discounts and concessions that Ingram Micro claimed it was owed, and that, Ingram Micro, in turn, would confirm to McAfee's outside auditors that it owed McAfee an undiscounted total of \$40 million. McAfee's outside auditors never received the confirmation in question from Ingram Micro. Ingram Micro nevertheless retained the \$21 million, canceled the outstanding discounts and reductions on its records, and later sent McAfee a check for approximately \$38 million as payment in full under the invoices in question.⁶ By participating in this round-tripping of cash payments with McAfee, Ingram Micro helped to create the false impression that McAfee had been paid in full on the outstanding invoices to Ingram Micro. As a result, Ingram Micro overstated its accounts payable for the quarter and its internal controls failed to alert Ingram Micro's senior management that the company was engaging in a highly irregular transaction that lacked economic substance.

Violations

21. A result of the conduct described above, Ingram Micro violated Exchange Act Section 13(b)(2)(A), which required Ingram Micro to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect its transactions.

22. As a further result of the conduct described above, Ingram Micro violated Exchange Act Section 13(b)(2)(B), which required Ingram Micro to devise and maintain a system of internal controls sufficient to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization.

Ingram Micro's Remedial Efforts

23. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Ingram Micro Inc. cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. IT IS FURTHER ORDERED that Respondent shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$15,000,000 to the Clerk of the United States District

⁶ McAfee's auditors relied on the fact that Ingram Micro had paid the invoiced amount in full as proof that Ingram Micro, in fact, owed that amount to McAfee.

Court for the Northern District of California to be added to the Distribution Fund established in SEC v. McAfee, Inc., Case Number C06-0009 (PJH). Respondent shall provide proof of payment, in a form acceptable to the staff of the Commission, to Yuri B. Zelinsky, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549. In the event the Court disallows such payment to the Distribution Fund then Respondent shall pay within ten (10) days after the Court disallows said payment \$15,000,000 to the United States Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Ingram Micro Inc. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Yuri B. Zelinsky, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549.

By the Commission.

Elizabeth M. Murphy
Secretary