UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES AND EXCHANGE COMMISSION, **100 F Street, N.E.** **Washington, D.C. 20549** **Plaintiff,** **v.** **EDWARD S. PLINER,** **13 Locust Street** **Salem, MA 01970** **Defendant.**	)))))))))))))	**Civil Action No.** **COMPLAINT**

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

SUMMARY

1. Between 1997 and 2001, Raytheon Company and certain members of its senior management ("Raytheon" or the "company") made false and misleading disclosures and used improper accounting practices that operated as a fraud by masking the declining results and deteriorating business of Raytheon Aircraft Company ("RAC") and inaccurately reporting the company's operating results on both a segmented and consolidated basis. As set forth below, certain of these disclosures and accounting practices were undertaken by or with the knowledge of senior company officers, including Edward S. Pliner ("Pliner"), the lead engagement partner on the Raytheon audit from 1997 through 1999 and the company's Corporate Controller from early 2000 through late 2002.

2. From 1997 through 1999, Raytheon prematurely recognized revenue on RAC's sale of unfinished aircraft through improper "bill and hold" transactions. As a result, the company materially overstated RAC's net sales by approximately $80 million at year-end 1997

and $110 million at year-end 1998, which led to 13 percent overstatements of the subsidiary's annual operating income in both of these periods. These errors also enabled both Raytheon and RAC to meet certain internal and external earnings targets. In January 2000, the company restated for the material errors related to RAC's improper bill and accounting practices.

3. In addition, between 1997 and 2001, Raytheon failed to fully and accurately disclose known risks, trends, uncertainties, and other information concerning the deteriorating state of RAC's commuter aircraft business and the negative impact this decline was having on asset values associated with RAC's line of nineteen-seat, turboprop aircraft (the "commuters" or the "1900s") and, thus, on the company's (including RAC's) results of operations. Raytheon also engaged in several improper accounting practices that delayed and mischaracterized known losses associated with RAC's commuter line during this time period.

4. As Raytheon's lead auditor, Pliner was aware of certain bill and hold and commuter accounting practices at RAC, which he knew or should have known were improper. Yet, he signed unqualified audit opinions for the 1997 and 1998 audits, which represented that the company's financial statements "present fairly, in all material respect, the financial position of Raytheon Company and Subsidiaries Consolidated…and the results of their operations…in conformity with generally accepted accounting principles." As Raytheon's Controller, Pliner continued to be aware of and involved in certain on- and off-balance sheet commuter accounting, which he knew or should have known did not accurately reflect the negative impact of declining commuter values in Raytheon's financial statements. Pliner further did not make or ensure the timely, accurate, and full disclosure of material commuter trends and uncertainties in Raytheon's SEC filings during 2000 and 2001, and he also did not ensure that the company maintained an adequate system of internal accounting controls related to these assets.

5. Had Raytheon properly accounted for its commuter assets, the company would have reported material reductions in RAC's reported operating income of at least $34 million, $22 million, and $21 million at year-end 1998, 1999, and 2000, respectively, which represented 13 percent of the subsidiary's reported annual operating income in each of these periods.

6. RAC's operating results would have been further reduced by at least $67 million (41 percent) at year-end 2000 had Pliner and others in senior Raytheon and RAC management timely and appropriately recognized losses inherent in a planned "soft landing" of the commuter aircraft line. Internal company documents and other information further indicate that, at this time, these and other senior executives expected commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing," and a charge of $67 million to $240 million would have reduced Raytheon's 2000 profit before taxes by at least 8 to 27 percent. Pliner and others, however, caused Raytheon to improperly take this charge in the third quarter of 2001, when the company wrote down its on-balance sheet commuter assets and increased reserves for its off-balance sheet commuter receivables by a total of $693 million after the terrorist attacks of September 11th. Given the charge that the company should have taken at year-end 2000, Raytheon's third quarter 2001 commuter loss provision was materially overstated by at least 10 to 53 percent.

JURISDICTION

7. This Court has jurisdiction over this matter pursuant to Section 22 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77v] and Sections 21(d)(3)(A) and 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d)(3)(A) and 78aa].

DEFENDANT

8. Pliner, age 49, has been a Certified Public Accountant licensed in Massachusetts at all relevant times. During 1997 through February 2000, Pliner served as the lead engagement partner on the audits of Raytheon's financial statements. From approximately April 2000 until December 2002, Pliner served as Raytheon's Controller and then became the company's CFO.

BACKGROUND

9. Raytheon is a Delaware corporation, headquartered in Waltham, Massachusetts. The company is an industry leader in defense, government electronics, space technology, and business and special mission aircraft. Between 1997 and 2001, Raytheon reported between $13 billion and $20 billion in net sales revenue annually and employed between 75,000 to 120,000 individuals. During this time period and continuing through today, Raytheon's securities have been registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the New York, Chicago, and Pacific Exchanges.

10. In the early 1990s, Raytheon was a diversified, multi-national conglomerate, which operated in the defense, electronics, engineering and construction, major appliances and aircraft businesses. The company formed RAC in 1994 through the combination of Beech Aircraft and Raytheon Corporate Jets, and the wholly-owned Raytheon subsidiary has been reported as a separate segment in all of the company's public filings since that time.

11. RAC manufactures, markets, and services business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. Due to the cyclical nature of these markets, RAC often experienced fluctuating results. For example, between 1997 and 2001, RAC generated between $2.3 billion and $3.2 billion in net sales revenue for the company annually, accounting for 13 to 19 percent of Raytheon's consolidated sales revenues. In addition, while the revenues generated by the commuter aircraft

product line represented approximately 1 percent of Raytheon's consolidated net sales revenue during this time period, the company's financing of those sales left Raytheon with substantial recourse obligations related to over $1 billion in commuter receivables that were off the balance sheet.

12. In 1997, Raytheon completed two multi-billion dollar defense acquisitions in an effort to streamline its operations and solidify its position as one of the nation's largest military contractors. These acquisitions led to a doubling of Raytheon's long-term debt load (increasing it to over $8 billion) and a substantial lowering of Raytheon's credit rating. In an effort to reduce the burden of its debt expense on earnings and cash flows, Raytheon began to divest many of its "non-core" commercial units, using the cash generated by these sales to pay down debt it incurred as a result of its defense acquisitions. RAC was considered for divestiture as part of this plan.

RAYTHEON'S IMPROPER BILL AND HOLD AIRCRAFT SALES

13. Between 1997 and 1999, RAC prematurely recognized revenue on improper "bill and hold" aircraft sales (also known as "green sales" or "financial deliveries") that did not comply with generally accepted accounting principles ("GAAP").

14. In particular, every quarter and more often at the end of the fiscal year, members of senior RAC management held "executive review sessions," in which they identified unfinished planes in the production process that could be "pulled forward" for a "financial delivery" to "bridge" certain "gaps" or "shortfalls" in RAC's performance targets. It was inappropriate to recognize revenue on these sales because the aircraft were not complete and ready for shipment, the seller (RAC) and not the purchaser had requested the bill and hold sale, and significant incentives (including no-interest loans during the completion period) were being

given to customers in order to induce them to accept a "sale" before quarter- or year-end, all of which disqualified the aircraft for sales treatment under GAAP.

15. In 1997, RAC's green sales resulted in an $80 million overstatement of the subsidiary's net sales, which artificially inflated RAC's quarterly operating income by between 13 and 28 percent, the subsidiary's annual operating income by 13 percent, and Raytheon's annual earnings by 7 cents per share. Raytheon did not disclose RAC's non-GAAP bill and hold practices in any of its 1997 Forms 10-Q or its Form 10-K, which each noted RAC's "record sales" and "record operating income." In January 1998, the company filed a Form S-3 registration statement and subsequent prospectus supplements for a $3 billion shelf registration and takedown of securities. These filings made no mention of RAC's improper bill and hold accounting and also incorporated by reference Raytheon's prior misleading periodic reports as well as all future periodic reports that Raytheon would file with the Commission.

16. In 1998, RAC's bill and hold sales inflated the segment's quarterly operating income by 20 and 100 percent in the second and fourth quarters, respectively, and RAC's annual operating income by 13 percent. Raytheon, however, did not disclose RAC's bill and hold practices in its 1998 SEC filings but again described RAC's "record" sales and operating income and "increased" aircraft shipments. In December 1998, Raytheon was aware that RAC had only been able to achieve its year-end sales and profit goals through "significant green sales" activity, which increased the company's fourth quarter earnings by 8 cents per share. As a result, Raytheon met analyst expectations that quarter. Raytheon's 1998 Form 10-K, however, stated that "Revenue from aircraft sales are generally recognized at the time of shipment," omitting a description of RAC's non-GAAP bill and hold accounting practices.

17. In 1999, RAC's improper bill and hold sales practices led to material misstatements of the subsidiary's operating income in the first, second, and third quarters. Raytheon again made no disclosure of these practices. In July 1999, the company filed another Form S-3 registration statement and subsequent prospectus supplements related to its $3 billion shelf registration and takedown of securities. These filings made no mention of RAC's improper bill and hold accounting practices and also incorporated by reference Raytheon's prior misleading periodic reports as well as all future filings made by the company.

18. At year-end 1999, Raytheon restated its prior financial results to correct the improper bill and hold accounting that had occurred prior to that time, which indicated that the company had materially misstated RAC's reported quarterly and annual operating income in the nine Forms 10-Q, and two Forms 10-K that the company had filed during fiscal years 1997, 1998, and 1999. The company's disclosures during this time period, however, improperly suggested that the restatement was due to the recent issuance of Staff Accounting Bulletin No. 101 in December 1999, which merely reiterated long-standing guidance on bill and hold transactions, instead of the improper accounting practices that had occurred at RAC with the knowledge and involvement of senior management prior to that time.

As Raytheon's Lead Auditor, Pliner Was Informed of RAC's Bill and Hold Practices

19. As the lead engagement partner on the 1997 and 1998 Raytheon audits, Pliner was provided documentation from the RAC audit team showing that (i) the planes which comprised RAC's green sales were not "complete" and "ready for shipment," (ii) RAC (the seller) and not the buyer was requesting the bill and hold delivery, and (iii) RAC management would further offer "fairly sizable incentives" (including no-interest loans) to induce the customer to accept a bill and hold sale prior to quarter- or year-end. Each one of these factors disqualified the

transaction for sales treatment under GAAP. Pliner was also provided documentation by the RAC audit team showing that the subsidiary's green sales had increased by 25 planes (66 percent) between 1997 and 1998. Pliner further knew that RAC had met its year-end 1998 profit and sales numbers due to its green sales activity. In 1998 and 1999, Pliner was also aware that the SEC had concerns with premature revenue recognition by public companies.

20. Yet, he and others on the audit team did not object to or raise any issues with Raytheon's improper accounting and disclosure practices related to RAC's non-GAAP bill and hold sales, as described in Paragraph Nos. 13 through 19 above. Instead, they continued to follow an approach that had been established on the audit before Pliner became engagement partner, which among other things provided that revenue could be recognized on aircraft that were not ready for delivery so long as they were "substantially complete" or "over 97% complete." This advice contradicted long-established guidance for bill-and-hold transactions.

21. Moreover, Pliner signed unqualified opinions for the 1997 and 1998 audits, which he knew or should have known misleadingly represented that Raytheon's financial statements comported with GAAP. Pliner was also aware that the 1997 audit report was incorporated by reference as part of Raytheon's January 1998 offering and the 1998 audit report was incorporated by reference as part of Raytheon's July 1999 offering.

RAYTHEON'S IMPROPER ACCOUNTING AND DISCLOSURES FOR ITS COMMUTER BUSINESS

22. Between 1997 and 2001, Raytheon also deferred substantial losses related to RAC's line of commuter aircraft. These planes were typically used by small, thinly capitalized airlines to transport passengers along regional or local routes. These carriers were generally seen as significant credit risks, were thus frequently unable to obtain independent financing for their

aircraft purchases, and typically lacked sufficient cash on hand to make outright purchases of RAC's commuter aircraft.

23. As a result, RAC rarely sold its new or used 1900s for cash. Instead, over 90 percent of RAC's sales were financed by the subsidiary's captive finance company, Raytheon Aircraft Credit Corporation ("RACC"), which often offered below-market interest rates and other favorable terms to customers in order to increase demand for the 1900s. RAC also regularly took used commuter aircraft (model 1900Bs and 1900Cs) in trade for the purchase of newer planes (model 1900Ds), which left RAC with a supply of used 1900s in inventory.

24. RACC sold most of its aircraft receivables, including commuter financing receivables, into a revolving credit facility funded by an outside bank syndicate, which removed the debt associated with these financed sales from the company's balance sheet. Under the terms of the credit facility agreement, Raytheon was obligated to re-purchase certain delinquent and defaulted receivables, and the level of recourse to Raytheon on the commuter receivables generally ranged between 75 to 100 percent depending upon the type of financing. RACC also renegotiated and restructured many of the payment arrangements it had with certain RAC customers in order to keep these customers from becoming overly delinquent or otherwise defaulting on their notes.

The Declining Commuter Market between 1997 and 1998

25. During the late 1990s, RAC began to experience softening demand for its commuter aircraft due to, among other things, shifting consumer preferences, increased government regulation of nineteen-seat aircraft, increased competition in the used aircraft market, and the introduction of regional jets. These and other factors combined to place downward pressure on the sales prices, lease rates, and asset values of these planes. Thus, in

1997, RAC began for the first time to place used 1900s with customers on operating leases and substantially ceased outright sales of used 1900s for cash.

26. In addition, many of the used commuters that RAC received as returns, repossessions, and trade-ins required significant refurbishment before RAC could re-market them. These refurbishment costs were capitalized as part of the aircraft's book value, which led to "[h]igher book values" that "can and do exceed fair market value." In response, RAC adopted a policy of depreciating the used commuter aircraft on an accelerated basis during the life of their leases to "bring down values" to amounts that were more likely to be recovered in later cash sales. By so doing, RAC improperly deferred and re-characterized impairment losses associated with high commuter book values as ordinary depreciation.

27. As Raytheon's lead auditor and later as Corporate Controller, Pliner was repeatedly informed that "[t]he most significant accounting issue for used commuters is the realizability of assets. Management's plan is to lease the aircraft, depreciated them down to 50% of book value over 10 years, and sell them to the freighter market at the end of the lease." Other Raytheon and RAC executives, including a senior financial officers in corporate and at the subsidiary, were also aware of this strategy and its effects.

28. In April 1998, Raytheon's internal audit department identified that the capitalization of RAC's refurbishment costs was leading to inflated book values for the commuter aircraft. Although senior RAC management agreed to establish limits on the carrying values of used 1900Cs at $3.4 million to $3.7 million in April 1999, at year-end, more than twenty 1900Cs in inventory had book values of more than $4 million per plane net of specific reserves.

29. By late 1998, Raytheon was aware of potential risks, uncertainties, and adverse trends in RAC's commuter business. For example, in October 1998, a RAC sales plan noted that the "US market continues to be soft for this size [of] aircraft." In December 1998, an internal Raytheon analyst wrote that "[t]he 19-seat turboprop market is in trouble" and described several factors that were "clearly putting the viability of the 1900D in doubt." Later that month, after being informed that "the market for the 1900D appears to be in decline" and "continuing 1900D financing is probably RAC's major financial exposure," Raytheon's new CEO observed that "clearly, the 1900D is a worry" and asked senior RAC management "how solid is our build/sell forecast?" The CEO further authorized a series of external studies into the future market demand for commuters and an internal financial analysis of the risks associated with these aircraft.

Raytheon's Improper Disclosures and Accounting in 1997 and 1998

30. Raytheon made no meaningful disclosures of the known risks, trends, and uncertainties associated with the deteriorating state of RAC's commuter business, such as the softening demand for commuters, the increasing trend in returns and repossessions, and the movement in RAC's commuter placement program away from sales and to begin offering leases, in any of the company's SEC filings from 1997 through 1998.

31. Raytheon also engaged in improper accounting for RAC's commuter business that served to offset the negative effects that the declining commuter market was having on asset values for the 1900s during this time period. For example, Raytheon transferred $15 million in "corporate reserves" to RAC at year-end 1997, which RAC initially used to "off-set" potential exposures associated with over-valued 1900s. The company did not properly disclose or account for these reserves, however, which represented 7 percent of RAC's reported annual operating income that year. Although this $15 million charge should have been taken to ordinary operating

income, Raytheon reported it as a "special charge" reflecting the write down of unidentified "non-current assets" at RAC. In addition, instead of using the charge to write down the non-current commuter assets held for lease, RAC ultimately used this reserve to absorb losses incurred in subsequent periods when aircraft were refurbished.

32. Furthermore, during 1997 and the first three quarters of 1998, Raytheon was aware that RAC had not implemented and was not complying with the requirements of FAS 125 (the new guidance for off-balance sheet accounting that became effective on January 1, 1997) to measure and record the assets and liabilities arising from its securitization arrangements. However, in its 1997 Form 10-K, the company stated that it had adopted this standard in 1997 and that this purported adoption "did not have a material effect on the company's financial position or results of operations." In 1998, Raytheon continued to be aware that "management ha[d] yet to record the sale of receivables in full accordance with FAS 125" and that "[t]he SEC has recently raised concerns about registrants' reporting under FAS 125." Yet, it was not until the fourth quarter of 1998 that RAC began to implement the aspects of FAS 125 related to the measurement and recording of assets and liabilities arising from the company's securitization arrangements. However, RAC based its FAS 125 calculations in 1998 on incomplete and inaccurate data and also improperly measured its recourse liability obligations on the receivables sold into the credit facility. As a result, for 1998, Raytheon reported additional operating income of $18 million on the sale of commuter receivables to the credit facility instead of a $9 million loss. Proper FAS 125 accounting would have reduced RAC's reported annual operating income by $27 million (11 percent) at year-end 1998.

33. RAC also established reserves for commuter losses equal to any FAS 125 gains that were recognized on the sale of commuter receivables. This practice of making perfectly off-

setting adjustments left no trace on RAC's reported earnings. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values. For example, in the fourth quarter of 1998, Raytheon recorded a $6.5 million gain on the sale of commuter receivables, which was offset by an equal $6.5 million reserve for commuters. No documentation supported the amount of the $6.5 million loss provision, and the amount reserved corresponded to nothing other than the amount of the recorded gain" At the time, the improper $6.5 million adjustment amounted to nearly 8 percent of the subsidiary's fourth quarter 1998 operating income of $82 million.

In 1997 and 1998, Pliner Knew or Should Have Known of Raytheon's Improper Commuter Accounting

34. As Raytheon's lead auditor, Pliner knew or should have known of the improper commuter accounting practices alleged in Paragraph Nos. 22 through 33 above. And, in 1998, Pliner was further informed that RAC's commuter customers were "weak credits" that required "frequent restructurings and repossessions." At that time, Pliner also knew of the SEC's "focus" on "earnings management" and the "qualitative aspects" of "materiality" including the "impact on segment or interim data, [and the] impact on trend[s]." Yet, as alleged above in Paragraph No. 21, he still signed unqualified audit opinions for the company's 1997 and 1998 financial statements, which he knew or should have known misleadingly stated that these results complied with GAAP.

The Deferral of Significant Commuter Losses in 1999

35. Throughout 1999, certain senior Raytheon and RAC officers were made aware of potential negative and adverse trends, uncertainties, and risks related to RAC's commuter business.

36. In April 1999, an outside consultant informed senior Raytheon and RAC management that the commuter market was "at a turning point," that other "[c]arriers have begun to flood the market with...used 19-seat airplanes," that "lease rates for used 19-seat aircraft [we]re declining," that the "[d]ownward pressure on lease rates w[ould] grow as the surplus of 19-seat aircraft expands," and that "[a]dditional lease rate pressures could impact the company's asset values and re-marketing efforts." A senior Raytheon financial officer received a copy of this report and both he and other Raytheon officers were briefed on this situation and management's views of it.

37. Also in April 1999, a senior Raytheon financial officer was informed that these "surplus" aircraft and "lower lease rates could drive declining asset values and represent a potential material write down" of the commuter assets. This officer was further informed that there was an "obvious" need for a "material write-down" of RAC's commuter assets, that these losses were "large and growing," that RAC was engaging in "misleading financial reporting," and that the situation was "as bad as [one executive had ever] seen." That same month, during their first meeting, Pliner discussed issues related to the commuters with this senior Raytheon financial officer.

38. In May 1999, an internal Raytheon study forecasted that RAC's commuter portfolio would generate an estimated $95 million in losses due to "[t]he lack of portfolio equity, poor customer credit and payment behavior, high loan-to-value ratios, and the modest level of reserves" established for these assets. That same study identified a "worst case scenario" that could generate $200 million in additional losses depending upon the impact of the "upcoming introduction" of regional jets. A senior Raytheon financial officer received a copy of this report,

and both he and other Raytheon officers were briefed on this situation and management's views of it.

39. In June 1999, Raytheon's then-Controller advised a senior Raytheon financial officer that there was an estimated exposure of $300 million to $500 million in marking the RACC portfolio to market.

40. Also in June 1999, senior Raytheon officers received a "response" from RAC to the April and May 1999 external and internal studies. This response set forth the view of RAC management that there was greater demand for new commuter aircraft than forecast by the company's outside consultant. RAC's response also advised that it was "a corporate decision" whether to "build reserves" on the commuters, but this would occur "at the expense of current period profits." RAC's response instead proposed addressing the $95 million commuter exposure identified in May 1999 through "third party, no recourse notes," which would provide an estimated $93 million "improvement." These sales did not materialize, however. Yet, reserves were not adequately increased.

41. In July 1999, in connection with an attempt to securitize all of RAC's aircraft receivables, the company's investment bankers informed Raytheon that the commuter portfolio should be valued "at a material discount to its current book value," that "actual collateral values may be substantially lower than loan balances," and that "[p]ortfolio policies may be masking problems from being recognized."

42. In August 1999, as part of an initial consideration to divest RAC, senior Raytheon officers were informed that there was "approximately $250 Million - $350 Million risk in [the] $2.4 Billion loan/lease portfolio," and the "risk is likely to approach the high end of this range

over time" since "about 40% of loan/lease payments are delinquent" and "business cycle downturn may also drive up defaults [and] reduce residual values of used aircraft."

43. In the Fall of 1999, after the initial effort to divest RAC failed, Raytheon attempted to sell RAC's portfolio of aircraft receivables (including its commuter receivables) to an outside finance company. The finance company, however, informed Raytheon that it would not purchase any of the commuter loans due to concerns over their high loan-to-value ratios and high concentrations in certain customers. The finance company also provided Raytheon with an independent valuation analysis of the 1900s, which stated that the commuter industry was experiencing a "distinct reduction in sales activity" and a "downturn" in leasing activity over the past year. This report also listed estimated market values for the 1900s that were below their book values.

44. In October 1999, due to unrelated difficulties in its defense businesses and engineering and construction unit, Raytheon announced an unexpected $640 million charge, which caused the price of the company's stock to fall 44 percent in one day. This charge also led to a downgrading of the company's bond and credit ratings, and Raytheon management continued with the strategy to pay down the company's debt by divesting certain "non-core" commercial units. As part of this strategy, senior Raytheon management undertook a new effort to divest RAC.

45. In addition, following a number of production and accounting problems that arose at RAC as part of the year-end 1999 close, the subsidiary's CEO stepped down from his executive position, and Raytheon's CEO traveled to the subsidiary to make it clear that RAC personnel had to improve their processes to prevent similar issues from occurring in the future.

Pliner and others were aware of these issues, including that RAC had to reverse certain accounting entries before Raytheon could release its financial results in early 2000.

46. Thereafter, in early 2000, RAC's newly-installed CEO instructed his staff to critically examine the subsidiary's operations, and RAC's Deputy CFO took the lead role in identifying issues to be examined. As part of this review, RAC personnel identified a potential $220 million exposure related to the commuter assets on and off the balance sheet. This estimate was calculated by comparing "[p]rices which could be readily obtainable in today's market" to commuter book values. The market values used in the analysis averaged from $500,000 to $1 million below the commuter book values. However, the company did not write down its commuter assets or adequately increase its commuter reserves at that time. Instead, based on overly optimistic internal analyses prepared by RAC executives, the company concluded that no "event of impairment" had occurred.

47. In January 2000, Raytheon had announced that it expected fourth quarter 1999 earnings to be lower than consensus estimates, that it was reducing its 2000 earnings forecast by 50 cents per share (over $200 million), and that it planned to restate for RAC's improper bill and hold accounting practices. Following this announcement, Raytheon's stock price fell approximately 17 percent in one day. And, by March 2000, it was reported that Raytheon's bond and credit ratings might be further downgraded "[i]f corrective actions do not lead to material long-term improvements in overall performance and its balance sheet, or if material new operating problems emerge...."

Raytheon's Improper Disclosures and Accounting in 1999

48. Raytheon's SEC filings for 1999 did not contain adequate disclosures of the negative and adverse trends, uncertainties, risks, and other information related to RAC's commuter aircraft or the subsidiary's commuter business.

49. While Raytheon's 1999 Form 10-K did refer to "commuter valuation costs" as one of five factors affecting RAC's "decline in operating income as a percent of sales in 1999," this disclosure failed to provide adequate information concerning the known material and adverse risks, uncertainties, and trends posed by the commuters.

50. In addition, the forward-looking statements in Raytheon's 1999 Form 10-K stated that "the effect of market conditions, particularly as it affects the general aviation market, the impact of competing products and pricing, [and] the impact on recourse obligations of RAC due to changes in the collateral value of financed aircraft" were among the many "factors that could cause actual results to differ," but did not mention "commuter" aircraft by name or provide adequate information about the negative trends, uncertainties, and risks concerning the commuters that were known to management at the time. Likewise, another set of forward-looking statements in Raytheon's 1999 Form 10-K stated that "continued market acceptance of, and government regulations affecting, 19-seat turboprop commuter aircraft" could affect RAC's future results of operations, but Raytheon did not disclose the significant information it had about the declining commuter market and the exposures facing the company.

51. These forward-looking statements were inconsistent with disclosures in the footnotes to the company's 1999 financial statements, which misleadingly stated that "the Company does not expect to incur any material losses against the net book value of the long-term receivables" because "it is the Company's policy to have the aircraft serve as collateral for the

commuter airline receivables;" that "any liability arising from these transactions will not have a material effect on the Company's financial position, liquidity, or results of operations" given Raytheon's experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future; and that "[t]hese financial instruments are recorded at estimated fair value. No material gain or loss resulted from the sales of receivables." As Raytheon was aware, the fair value of the commuter aircraft serving as collateral for the corresponding receivables was declining given the deteriorating market conditions for these planes. Yet, the company was not adequately increasing its reserves for these anticipated short falls, causing significant potential future liability under its recourse provisions to the revolving credit facility.

52. In addition, contrary to the company's footnote disclosures, during 1999, RAC continued its incorrect practice of using FAS 125 gains on commuter receivables sold into the credit facility to set up equally off-setting commuter loss reserves. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values.

53. For example, in the third quarter of 1999, RAC increased its "cushion" for commuter losses by roughly $11 million given the improper FAS 125 gains it recognized on the sale of commuter receivables into the credit facility. RAC, however, subsequently reduced that increase by roughly $7 million in the fourth quarter of 1999 that offset a significant FAS 125 loss caused by a reduction in Raytheon's credit rating. These adjustments represented approximately 17 and 19 percent of the subsidiary's reported operating income/loss in the third and fourth quarters of 1999, respectively.

54. Also, RAC still had not properly applied FAS 125 to its off-balance sheet commuter receivables during 1999. As a result, RAC's reported annual operating income should have been reduced by at least $21 million (13 percent) at year-end.

Near Conclusion of the 1999 Audit, Pliner Was Offered the Position of Raytheon's Corporate Controller

55. During the course of the 1999 audit, Pliner continued to learn of Raytheon's deteriorating commuter business, and he knew or should have known about Raytheon's improper commuter accounting. For example, Pliner knew of the additional commuter reserves established through FAS 125 gains during the third quarter of 1999. And, at year-end 1999, Pliner informed members of senior Raytheon management of a "continued concern about commuter portfolio exposure," how "higher refurb[ishment] costs on used commuters" accounted of a $15 million decrease in RAC's operating profit that year, how the company "need[ed] to relook at FAS 125 calculations based on higher refurb costs," how the used commuter inventory was projected to be "higher than prior years" in 2000, and if there is "any slip," the commuter inventory "balance will balloon." However, because he was offered a position as Raytheon's Corporate Controller shortly after presenting the audit results, Pliner rotated off the Raytheon engagement before the 1999 audit opinion was signed.

In 2000, the Commuter Market Continued to Deteriorate

56. In 2000, a variety of internal and external sources continued to inform Raytheon and RAC executives that the market for 1900s was in substantial decline. These sources further indicated that there were actual material commuter losses at RAC and that the potential losses associated with the 1900 line were in the hundreds of millions of dollars.

57. In January 2000, senior Raytheon and RAC officers learned that the company's strategic planning department viewed RAC as having a substantial negative economic value due

in large part to $240 million in negative value and exposure associated with RAC's off-balance sheet commuter and general aviation receivables.

58. In February 2000, an outside consultant reported to Raytheon that there would be "[c]ontinued downward pressure on turboprop lease rates due to falling demand for new units and a growing supply of used capacity" and that "demand for new [commuters] will average 7 to 12 sales annually," well below what RAC was planning to manufacture that year.

59. In March 2000, auditors with a major public accounting firm that had been retained to perform a review of RAC's "used commuter program exposures" informed members of senior Raytheon and RAC management that "the Company's largest exposure in the [commuter] portfolio is with potential returned aircraft" and that "the book values of certain aircraft in the portfolio exceed the current market values." In particular, these auditors identified a $115 million "shortfall" associated with RAC's 1900Cs that were on and off the balance sheet, assuming a strategy of selling the aircraft for cash at their fair market value. The auditors also noted that RAC personnel were "rejecting cash offers on commuter aircraft because of the income statement repercussions . . . [implying that] the carrying amounts of commuter airplanes exceed their fair market values." The auditors further noted that RAC only wrote down used commuter asset values "when the Company enters into a new finance/lease transaction." The auditors also reported that RAC lacked formal and documented policies and practices concerning the accounting for commuter aircraft, commuter loan restructurings, the creation of commuter valuation reserves, and the monitoring of customer accounts and collections. Pliner received a copy of the report prepared by these auditors and discussed this report with a senior Raytheon financial officer after becoming Controller.