

CHARTING A COURSE: REVENUE RECOGNITION PRACTICES FOR TODAY'S BUSINESS ENVIRONMENT

George B. Parizek

Madeleine V. Findley¹

Sidley Austin LLP

Washington, D.C.

Regulators and the plaintiff's bar have frequently been critical of issuer revenue recognition practices. Typically, after negative earnings reports or announcements of financial restatements, regulators and private plaintiffs, employing the benefits of hindsight, evaluate issuers' financial statements and disclosures in a search for indicia of actionable financial fraud, including "managed earnings." The economic forces of the early 1990s generated pressures that led to numerous examples of overaggressive revenue recognition practices, often met by swift and typically stiff regulatory responses.² Former SEC Chairman Arthur Levitt characterized these pressures in his famous "Numbers Game" speech, "In a market that is unforgiving of companies that miss their [Wall Street analysts'] estimates," "the motivation to meet Wall Street earnings expectations may overrid[e] common sense business practices."³ As corporate America approaches the end of fiscal year 2008, the needle on the economic compass again points to difficult economic times. And with it, a pause for a thoughtful look at revenue recognition policies and practices—by financial reporting professionals, audit committees that oversee their work, and executives that sign Sarbanes-Oxley Act certifications—is warranted.

I. OVERVIEW

This article examines one practice that may be emblematic of improper earnings management: "channel stuffing." Channel stuffing is the practice of bringing revenue forward from future fiscal periods by inducing customers to submit purchase orders in advance of when they would normally have done so.⁴ The obverse to channel stuffing, in contrast, are pull-in sales, which are existing orders shipped in the current quarter rather than in a later quarter as originally scheduled.⁵ Channel stuffing is not fraudulent *per se*. And it does not necessarily result in the improper recognition of revenue under GAAP.⁶ But "[c]hannel stuffing may amount to fraudulent conduct when it is done to mislead investors."⁷ Revenues derived from channel stuffing (and pull-in sales) may also create disclosure obligations under Items 101(c)(1)(i) ("Description of Business")⁸ and 303 ("Management Discussion and Analysis")⁹ of Regulation S-K.¹⁰ However, provided that the sales at issue are unconditional and any rights of return are properly treated, the sales may properly be booked as revenue.¹¹

This article reviews recent enforcement actions and pronouncements to highlight issues and concerns that the Securities and Exchange Commission (SEC) and related regulatory organizations, including the Public Company Accounting Oversight Board (PCAOB), historically have raised when issuers recognize revenues generated from channel stuffing sales

practices.¹² It also offers various issues that financial reporting management may want to consider in analyzing sales, and potential revenue recognition abuses, when the results are pulled from an oversold inventory channel.

II. SEC ENFORCEMENT ACTIONS

As part of its financial reporting enforcement program, the SEC frequently sanctions issuers who recognize revenues that do not satisfy GAAP requirements. Sanctions for violations can be severe. Settlements in SEC enforcement actions have ranged from judgments imposing significant financial penalties and disgorgement of ill-gotten gains, to entry of civil injunctions, to officer and director bars, to bars from appearing and practicing before the Commission (pursuant to Rule 102(e)) imposed against market professionals and other gatekeepers, including lawyer and accountants.¹³ Four notable cases—*SEC v. Bristol-Myers Squibb, Co.*; *In re Sunbeam*; *In re Microtune, Inc.*; and *SEC v. Symbol Technologies, Inc.*—brought by the SEC against issuers and their management included allegations of improper recognition of sales achieved through channel stuffing practices.¹⁴ A review of these cases suggests that the SEC may sanction issuers for prematurely recognizing revenues derived from channel stuffing where issuers (i) include rights of return, (ii) have inadequate return reserves, or (iii) liberalize or abandon previous accounting policies, thereby creating significant revenue recognition risks.¹⁵

A. SEC v. Bristol-Myers Squibb, Co.

The SEC sanctioned Bristol-Myers Squibb (“BMS”) and its senior management for allegedly engaging in a fraudulent scheme to overstate its sales and earnings in order to create the false appearance that the company had met or exceeded financial targets and earnings estimates established by Wall Street securities analysts. *SEC v. Bristol-Myers Squibb, Co.*, Lit. Rel. No. 18820 (Aug. 4, 2004). BMS allegedly accomplished this by using improper accounting and by recognizing revenues from non-GAAP sales to its two largest wholesalers, including approximately \$1.5 billion in revenue from sales achieved through “channel-stuffing.” In addition, BMS allegedly used “cookie jar” reserves¹⁶ to meet internal sales and earnings targets, again in an effort to meet analysts’ estimates.

BMS allegedly perpetrated a channel-stuffing scheme by:

- Selling excessive amounts of pharmaceutical products to its two biggest wholesalers ahead of demand near the end of every quarter in amounts sufficient to meet its targets (channel stuffing);

- Covering the wholesalers' carrying costs;
- Guaranteeing the wholesalers a return on investment until they sold the products; and
- Recognizing \$1.5 billion in revenue from these sales upon shipment, rather than on acceptance.

These concessions, however, introduced consignment-like contingencies into the sales, rendering the recognition of the sales as revenue non-GAAP compliant. BMS, according to the SEC's allegations, materially understated its accruals for customer rebates as a result of the practices. The SEC filed an enforcement action in federal court against the company. In settling the action, BMS agreed to a \$150 million civil penalty and shareholder payment, and a permanent injunction against future violations of certain provisions of the federal securities laws. BMS also agreed to various remedial measures, including appointing an independent auditor to oversee its accounting practices, financial reporting and disclosure processes.¹⁷ The SEC viewed BMS's actions as "distort[ing] the true performance of the company and its medicines business on a massive scale and caus[ing] significant harm to [its] shareholders."¹⁸

B. *In re Sunbeam*

The SEC sanctioned Sunbeam and its senior management for allegedly orchestrating a scheme to create the illusion of a successful restructuring of the company to facilitate its sale at an artificially inflated price. *In re Sunbeam Corp.*, Rel. No. 33-7976 (May 15, 2001). Sunbeam accomplished this goal by creating improper accounting reserves and by recognizing revenues from non-GAAP sales, with a portion of the improper revenue gain allegedly achieved through "channel-stuffing."

Sunbeam allegedly initiated its channel stuffing program by offering reluctant distributors favorable concessions, including:

- "Bill and hold" rights;
- Payments for the cost of storage, shipment, and insurance of the product; and
- Return privileges, through explicit agreement or allegedly established practice.

These concessions, however, introduced contingencies into the sales, rendering them non-GAAP compliant for purposes of revenue recognition.

Applicable accounting criteria for bill and hold transactions require that (i) the buyer and *not* the seller must request the transaction on a bill and hold basis; (ii) the buyer must have a substantial business purpose for ordering the goods on a bill and hold basis; and (iii) the risks of ownership must have passed to the buyer. *Id.* (citing *In re Stewart Parness*, Rel. No. 34-23507 (Aug. 5, 1986)). Additional relevant factors for evaluating bill and hold transactions cited by the SEC included “whether [the seller] has modified its normal billing and credit terms for this buyer” and “the seller’s past experiences with and pattern of bill and hold transactions.” *Id.*

The SEC found that Sunbeam’s “bill and hold” transactions did not comply with the above criteria. First, Sunbeam induced customer orders by offering sales concessions and, accordingly, the buyers *did not* initiate the bill and hold sales. Second, buyers purchased the products in order to obtain Sunbeam’s concessions and, as a result, the SEC deemed Sunbeam’s inducement (i.e., offering a bill and hold sale) as not qualifying as a “substantial business purpose” of the buyer. Finally, the SEC noted that buyers did not accept the risks of ownership because Sunbeam, on many occasions, provided rights of return and paid the costs of insuring, storing, and shipping the product. The SEC ultimately concluded that Sunbeam’s channel stuffing campaign amounted to “little more than projected orders disguised as sales.” *Id.*

Once Sunbeam began offering its customers discounts and other incentives to induce them into placing purchase orders before they would otherwise have done so, according to the SEC, the company was forced to continue the program in subsequent quarters or face a substantial earnings shortfall. Sunbeam therefore continued to offer the above “bill and hold” incentives, which the SEC alleged effectively amounted to the company bearing “all costs associated with the product until the customers requested delivery.” *Id.*

Sunbeam demonstrates that while sales may generally comport with GAAP requirements, the economic stress created by pulling sales from future quarters can create enough pressure that management may be forced to include sales incentives to catch-up on “borrowed revenues,” thus making the “sales” non-GAAP compliant.

C. *In re Microtune*

The SEC’s action against Microtune, Inc. demonstrates the degree of attention FAS 48¹⁹ requirements will receive when the Staff evaluates the merits of a channel stuffing program. *In re Microtune, Inc.*, Rel. No. 33-8596 (July 28, 2005). The SEC brought enforcement proceedings against Microtune for allegedly orchestrating a revenue-inflation scheme by entering into very favorable sales agreements with at least five distributors that included sales

concessions, expanded rights of return, and extended payment terms. Microtune also overshipped product to at least two distributors in an effort to stuff its distribution channels.

The SEC's Administrative Order noted that these liberal sales concessions were designed to induce Microtune's customers and distributors to issue purchase orders for product quantities exceeding their inventory needs or demands. The sales concessions were conveyed to customers and distributors orally, by email, and through side agreements. Microtune offered expanded rights of return (characterized as "stock rotation" rights) and extended payment terms to its distributors. The Order included a detailed discussion of the FAS 48 requirements,²⁰ noting that where the buyer has not paid the seller and has no obligation to pay until the product is resold, the seller cannot recognize revenue from the "sale."

Because of the price protections and expanded rights of return included in side agreements with the distributors, Microtune's product price was not substantially fixed, as required by FAS 48, or determinable at the date of sale. The SEC further discussed in detail the deliberate failure of certain senior Microtune managers to include the sales concessions in the purchase orders submitted to Microtune's accounting department. In at least one instance, Microtune shipped unfinished product as part of an overshipment, but did not disclose to the accounting department the likelihood of returned product. In its Order, the SEC emphasized the timing of the transactions (near the end of the quarter or the fiscal year) and the negotiations between the parties, signaling that the understanding of the buyers/customers is a significant factor for consideration.

In re Microtune suggests that the SEC will scrutinize the economic circumstances surrounding a transaction, the understanding of all of the parties to the transaction, and carefully evaluate FAS 48's requirements when assessing revenue recognition judgments involving sales that appear to be the result of concerted channel stuffing programs.

D. *SEC v. Symbol Technologies, Inc.*

The SEC action against Symbol Technologies and eleven of its officers illustrates how the SEC may view critically departures from internal accounting policies in order to recognize revenues. *SEC v. Symbol Techs., Inc.*, No. 04-2276 (E.D.N.Y. 2004). In its enforcement action, the SEC alleged that Symbol engaged in a variety of fraudulent practices, including

- Adjusting financial results to match management's forecasts;
- Creating "cookie jar" reserves by artificially reducing operating expenses;

- Engaging in channel stuffing in both product sales and customer services; and
- Manipulating inventory levels and accounting data to conceal the scheme's adverse effect.

The SEC's Complaint also carefully details instances where company personnel abandoned internal policies, including, among other practices:

- Granting resellers rights of return and contingent payment terms in side agreements whenever sales fell short of company targets;
- Shipping the wrong product when the product ordered by the customer was unavailable; and
- Backdating phony "bill and hold" letters from customers.

The Complaint further alleged that Symbol's lack of adequate internal controls exacerbated the situation. Each area of the company performed its own finance function that fed directly into the financial reporting performed at the corporate level. The nine-claim complaint alleged violations of securities laws and internal company policies.²¹ Without admitting or denying the complaint's allegations, Symbol entered a settlement with the SEC, whereby it paid a \$37 million penalty and consented to a permanent injunction against future securities law violations. *SEC v. Symbol Techs., Inc.*, Lit. Rel. No. 18734 (June 3, 2004).

Although pulling sales from future quarters may not always violate GAAP requirements, as the above actions illustrate, the SEC will scrutinize these practices (and the facts and circumstances surrounding them) to ensure that management has properly recognized revenue and adequately reserved for future returns.²²

III. STAFF ACCOUNTING BULLETIN NO. 101

SAB 101 is not a rule or standard as it was not subjected to the procedural due process protection of notice and comment. Moreover, SAB 101 disavows that it represents the views of the SEC Commissioners or the Commission itself. *Revenue Recognition in Financial Statements*, Rel. No. SAB 101 (Dec. 3, 1999). Nevertheless, it provides guidance as to the SEC Staff's views in applying GAAP principles to revenue recognition, reminding issuers of a basic guideline that "revenue should not be recognized until it is realized or realizable and earned." *Id.* at 3. And, as at least one influential commentator has noted, SAB 101 "fundamentally change[d] existing market practices."²³

SAB 101 instructs that revenues generally are not realized or realizable and earned unless the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services have been rendered;
- The seller's price to the buyer is fixed or determinable; and
- Collectivity is reasonably assured. *Id.*

Although phrased in general terms, these criteria provide guidance regarding revenue recognition across business models. SAB 101 provides additional guidance for revenue recognition issues facing “non-traditional” business models, including “side” agreements, timing and approval of sales agreements, consignment arrangements, “bill and hold” sales, and cancellation or termination provisions. *Id.* SAB 101 provides additional instruction concerning the above criteria through a series of hypothetical questions and answers. The SEC elaborated on these instructions in a Frequently Asked Questions and Answers (“FAQ”) created to address issues relating to SAB 101. *Revenue Recognition in Financial Statements—Frequently Asked Questions and Answers* (Oct. 26, 2001), at <http://sec.gov/info/accountants/sab101faq.html>. SAB 101 question number 3 specifically addresses the delivery and performance criterion and includes a discussion of channel stuffing practices.²⁴ SAB 101 cautions issuers that “if uncertainty exists about customer acceptance, revenue should not be recognized until acceptance occurs.” SAB 101 at 7.

SAB 101 notes that where customer acceptance provisions (such as product testing or installing requirements) are included in a purchase contract, the seller “should not recognize revenue until customer acceptance occurs or the acceptance provisions lapse.” *Id.*

To the extent that a seller has substantially completed or fulfilled its contractual obligations, SAB 101 provides that if (i) only “inconsequential or perfunctory actions remain incomplete,” (ii) a failure to complete the actions will not result in a refund or rejection of the product, (iii) the seller has a demonstrable history of timely completing the remaining tasks, and (iv) the seller has a reliable way of estimating the costs of completing the actions (and they are accrued), then revenue may be recognized under the “substantially complete” requirements of SFAC No. 5 ¶ 83(b). SAB 101 at n.22; *see also* FAQ at 3 & n.5 (same).

IV. ISSUES TO BE CONSIDERED

As discussed above, the SEC, through its enforcement program and Staff pronouncements, has placed financial reporting professionals and their advisors on notice that the pulling forward of revenues must be the result of *bona fide* sales and not merely future orders camouflaged as today's sales. Listed below are several items worthy of consideration when evaluating the merits of recognizing revenues derived from channel stuffing sales.

1. What are the understandings of the parties (both oral and written [including emails])? Does persuasive evidence of an arrangement exist?
2. Is the sales arrangement subject to further approval (*e.g.*, by the management committee or board of directors) or execution by the buyer?
3. Are there additional written or oral agreements (*e.g.*, side letters) related to the transaction? Providing for cancellation, termination, and return rights?
4. Is the seller's price to the buyer fixed or determinable? Is collectivity reasonably assured?
5. Are there contingencies that may impair rights of payment or collection? Have the contingencies lapsed?
6. Are there deviations from internal accounting policies or practices (*e.g.*, has the seller modified its normal billing and credit terms for this buyer)?
7. What are the nature of the sales or purchase agreement's return rights? If rights of return exist (as a matter of contractual right or practice), do they satisfy FAS 48's requirements?
8. Has title passed to the buyer upon delivery? Has the buyer assumed the risks and rewards of ownership of the products upon delivery?
9. Is the transaction a bill and hold transaction? If so, are the *Parness* criteria (*see supra* at Part II.B.) satisfied?
10. Is the seller's price to the buyer substantially fixed or determinable at the date of the sale?

11. Has the buyer paid the seller? Has the seller retained any specific performance obligations such that the seller's earning process is not complete?
12. Does the buyer's obligation to the seller change in the event of theft, physical destruction, damage of the product or decline in the market value of the goods?
13. Has delivery occurred to the customer's place of business or another site specified by the customer? Is there evidence of a formal acceptance of the product by the customer?
14. Does the agreement include customer acceptance provisions (*e.g.*, customer rights to (i) test the delivered product; (ii) installation or activation of delivered equipment; or (iii) performance of additional services)?
15. Are there undelivered elements that are essential to the functionality of the delivered product?

V. SOUND REVENUE RECOGNITION PRACTICES BEGET RECOGNIZABLE REVENUES.

There are two inescapable realities that accompany revenue recognition decisions—judgments will need to be made and could later be second guessed. Accordingly, to the extent an issuer chooses to pull forward revenue from future periods, the SEC, through its enforcement actions and Staff pronouncements, has signaled that it expects such decisions to include a thorough and detailed analysis of applicable GAAP requirements to the sales. At a minimum, the analysis should include a careful assessment of all relevant facts and circumstances surrounding a transaction, including (i) the understanding between the parties (both oral and written), (ii) the economic realities of the transaction, (iii) attention to any contingencies that may impair rights of payment or collectability and channel visibility (making reasonable estimates for sale returns difficult), and (iv) the reasons for any deviations from disclosed and undisclosed internal accounting policies. In light of the economic pressures facing corporate America, one of the best defenses available against an enforcement action (or private plaintiff's claim) is scrupulous attention to proper revenue recognition.

ENDNOTES

1. George Parizek is a partner resident in Sidley Austin LLP's Washington, D.C. offices and a member of Sidley's Securities Litigation and SEC Enforcement Practice Group. Madeleine Findley is associated with Sidley's Washington, D.C. office and a member of the Firm's Litigation Practice Group. This article is a private publication of the authors, expresses only the author's views, and does not necessarily reflect the views of Sidley Austin LLP or any client of the Firm. The authors would like to thank and acknowledge Paul V. Gerlach, a senior partner at Sidley Austin LLP and co-Chair of the Firm's Securities Litigation and SEC Enforcement Practice Group, and Michael Hyatte, a senior partner in Sidley's Corporate Department, for their assistance with this article.
2. "More than half of the financial reporting frauds among U.S. public companies from 1987 to 1997 involved overstating revenue." Thomas J. Phillips, Jr., et al., *The Right Way To Recognize Revenue*, J. of Accountancy (June 2001), available at <http://www.aicpa.org/pubs/jofa/jun2001/phillips.htm>; see also Roel C. Campos, *Remarks of SEC Commissioner*, 55 Case Western L. Rev. 528, 534-35 (2005) (discussing SEC v. O'Shaughnessy, Lit. Rev. No. 18120, No. 03-CV-3022, 2003 SEC LEXIS 1041 Apr. 30, 2003)); Press Rel., U.S. Sec. & Exch. Comm'n, *Bristol-Myers Squibb Company Agrees to Pay \$150 Million to Settle Fraud Charges* (Aug. 4, 2004), available at <http://www.sec.gov/news/press/2004-105.htm>.
3. SEC Comm'r Arthur Levitt, *The Numbers Game* (Sept. 28, 1998), available at <http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt>.
4. See *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 81 (1st Cir. 2002) (quoting *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999)).
5. *In re Cypress Semiconductor Sec. Lit.*, 891 F. Supp. 1369, 1380 (N.D. Cal. 1995).
6. *Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1261-62 (11th Cir. 2006); see also *Greebel*, 194 F.3d at 202 ("There is nothing inherently improper in pressing for sales to be made earlier than in the normal course."). Revenues derived from channel stuffing (and pull-in sales) may create disclosure obligations under Items 101(c)(1)(i) ("Description of Business") and 303 ("Management Discussion and Analysis") of Regulation S-K. See *In re Cypress Biosciences Inc.*, AAER No. 817 (1996) (SEC sanctioned issuer for failing to disclose the acceleration of material amounts of sales revenue as a business practice and discuss the financial implications for future fiscal periods.); see also Manning G. Warren III, *Revenue Recognition and Corporate Counsel*, 56 S.M.U.L. Rev. 885,

- 921 (2003) (“While channel stuffing may not be inherently fraudulent companies employing this device have duties to disclose both its use and the material impact it will likely have on future revenues.”).
7. Garfield, 466 F.3d at 1262.
 8. 17 C.F.R. § 229.101.
 9. 17 C.F.R. § 229.303.
 10. See *In re Cypress Biosciences Inc.*, AAER No. 817 (1996) (SEC sanctioned issuer for failing to disclose the acceleration of material amounts of sales revenue as a business practice and for failing to discuss the financial implications for future fiscal periods.); see also Warren, *supra* note 6, at 921 (“While channel stuffing may not be inherently fraudulent companies employing this device have duties to disclose both its use and the material impact it will likely have on future revenues.”).
 11. See Staff Accounting Bulletin 101; Richard Sauer, *Financial Statement Fraud: The Boundaries of Liability under The Federal Securities Laws*, 57 *Bus. Law.* 955, 971 (2002). Pull-in sales do not necessarily result in the improper recognition of revenue under GAAP. *In re Cypress Semiconductor Sec. Lit.*, 891 F. Supp. at 1381 (“They are actual sales treated no differently than any other sale, i.e., revenue is recognized upon shipment to the customer.”)
 12. See, e.g., PCAOB Release, Appendix D: Examples of Significant Deficiencies and Material Weaknesses, PCAOB Rel. 2004-001 (Mar. 9, 2004), available at http://www.pcaobus.org/Rules/Docket_008/2004-03-09_Release_2004-001_Appendix_D.pdf.
 13. Phillips, et al., *supra* note 2.
 14. See also Press Rel., U.S. Sec. & Exch. Comm’n, SEC Charges McAfee, Inc. with Accounting Fraud; McAfee Agrees to Settle and Pay a \$50 Million Penalty (Jan. 4, 2006), available at <http://www.sec.gov/news/press/2006-3.htm>; Lit. Rel. No. 19520, *SEC v. McAfee, Inc.*, Civil Action No. 06-009 (N.D. Cal. Jan. 4, 2006).
 15. Additional enforcement actions in recent years have targeted premature revenue recognition in long-term service contracts, *SEC v. i2 Technologies, Inc.*, Lit. Rel. 18741, Civil Action No. 3:04 CV 1250, 2004 SEC LEXIS 1187 (June 9, 2004); *In re Critical Path, Inc. Securities Lit.*, 156 F. Supp. 1102 (N.D. Cal. 2001); illegal “round-tripping” in the internet advertising context, *In re Homestore.com, Inc. Securities Litigation*, 347 F. Supp. 2d 769 (C.D. Cal. 2004).

16. “Cookie jar” reserves involves the practice of saving surplus profits in a fund (“cookie jar”) to offset losses in subsequent years. See Walter P. Schuetze, Speech by SEC Staff: Cookie Jar Reserves (Apr. 22, 1999), available at <http://www.sec.gov/news/speech/speecharchive/1999/spch276.htm>.
17. Press Rel., U.S. Sec. & Exch. Comm’n, SEC Charges McAfee, Inc. with Accounting Fraud; McAfee Agrees to Settle and Pay a \$50 Million Penalty (Jan. 4, 2006), available at <http://www.sec.gov/news/press/2006-3.htm>.
18. Campos, *supra* note 2, at 537.
19. FAS 48 provides criteria for recognizing revenue on a sale in which a product may be returned (as a matter of contractual right or practice) either by the ultimate customer or resellers. FAS 48, ¶ 3. Where a seller gives a buyer return rights, FAS 48 specifies that revenue from the transaction “shall be recognized at time of sale only if all of the following conditions are met:

The seller’s price to the buyer is substantially fixed or determinable at the date of sale;

The buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on the resale of the product;

The buyer’s obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product;

The buyer acquiring the product for resale has economic substance apart from that provided by the seller;

The seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer;

The amount of future returns can be reasonably estimated.

Sales revenue and cost of sales that are not recognized at the time of sale because the foregoing conditions are not met shall be recognized either when the return privilege has substantially expired or if those conditions subsequently are met, whichever occurs first.” FAS 48, ¶ 6.
20. FAS 48 provides that all relevant facts and circumstances should be considered when evaluating the ability to make a reasonable estimate of the amount of future returns. FAS 48, ¶ 8. It further

provides that “the following factors may impair the ability to make a reasonable estimate: (a) [t]he susceptibility of the product to significant external factors, such as technological obsolescence or changes in demand; (b) [r]elatively long periods in which a particular product may be returned; (c) [a]bsence of historical experience with similar types of sales of similar products, or inability to apply such experience because of changing circumstances, for example, changes in the selling enterprise’s marketing policies or relationships with its customers; [and] (d) [a]bsence of a large volume of relatively homogenous transactions. The existence of one or more of the above factors, in light of the significant of other factors, may not be sufficient to prevent making a reasonable estimate; likewise, other factors may preclude a reasonable estimate.” FAS 48, ¶ 8.

21. Courts have held that departures from undisclosed internal accounting policies may be relevant to show how a company complied, or failed to comply, with GAAP. *In re Cirrus Logic*, 946 F. Supp. 1446, 1458-59 (N.D. Cal. 1996). Deviations from a company’s internal policies may provide evidence of scienter if those deviations also violate GAAP. *Id.* at 1463.
22. The First Circuit observed that prior to the Private Securities Litigation Reform Act, “a number of [district] courts gave weight to channel stuffing allegations in refusing to grant stays of discovery or motions for dismissal or summary judgment.” *Greebel*, 194 F.3d at 203. In *Greebel*, however, when applying PSLRA pleading requirements, the First Circuit reasoned that allegations of channel stuffing practices, without more, do not support a “strong inference of scienter.” *Id.*; accord *In re Dura Pharma, Inc. Sec. Lit.*, Fed. Sec. L. Rep. P. 91,245 (S.D. Cal. 2000). Under the PSLRA, “[a] complaint will survive only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Tellabs Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2510 (2007).
23. Commissioner Paul S. Atkins, Remarks before the American Institute of Certified Public Accountants (Dec. 5, 2005), available at <http://www.sec.gov/news/speech/spch120505.htm>.
24. The “Facts” of hypothetical question 3 provide: “Company A receives purchase orders for products it manufactures. At the end of its fiscal quarter, customers may not yet be ready to take delivery of products for various reasons. These reasons may include . . . a lack of space for the inventory, having more than sufficient inventory in their distribution channel, or delays in customers’ production schedules.” SAB 101, at 6 (emphasis supplied).