

Peregrine fraud essay



**ASSIGN
BUSTER**

Peregrine Systems was founded in 1981 in Irvine, California. The founders were Chris Cole, Gary Store, Deed Beck, Kevin Keyes and Richard Dietrich. "The company was focus on developing enterprise solutions that would help organizations address precise business problems, and asset management practices for reduced costs, improved productivity and service and lower risk." Peregrine Systems was headquartered in San Diego, California and had offices in America, Europe and Asia Pacific.

Peregrine Systems went public in April 1997, and after his first public offering, he company reported seventeen uninterrupted quarters of revenue growth through the quarter ended June 30, 2001. According to the law suit filed by the Securities and Exchange Commission (SEC), in the United States District Court of San Diego, "the peregrine executives inflated the revenue reported in their filings with the commission and elsewhere. Executives, business partners and Auditors, used deceit and lies to represent Peregrine Systems as a corporation with constant increasing sales while hiding their persistent failure to achieve revenue forecast. Peregrine executives also sold Peregrine stock to an uninformed market, enriching themselves by millions of dollars, at the cost of the public that invested in the company. In February 2003, Peregrine Systems restated its financial statements for eleven quarters during the years 2000, 2001 and 2002, decreasing incomes formerly reported of 1.34 billion by more than\$ 507 million." The center of Peregrines fraud consisted in recording revenue on the inappropriate basis of non-binging contracts with resellers (channel partners), a complete violation of Generally Accepted Accounting Principles, - these resellers would purchase Peregrines software for resale to end-users.

The agreements would not meet the requirements for revenue recognition based on GAP because the lack of the following: a) evidence of an agreement must exist, b) delivery of the product must have occurred, c) the vendor's fee or cost must be fixed and determinable and d) collegiality must be probably. Senior executives would calculate at the end of each quarter how much extra sales or revenue the company needed to meet or surpass analyst expectations. They would then enter into quarter-end deals with the channel partners, which include backdated agreements, oral contracts or written side agreements.

The recording of this sales or revenue deceive investors into believing that the company's financial situation was stable, which inflated artificially Peregrines stock price. As if it not enough, Peregrines sold its uncorrectable receivables to banks and eliminated the receivable from the balance sheet, but these receivable financing deals, however, were in actuality loans and not sales, because under the terms of the contract, the banks had recourse against Peregrine if the clients did not pay.

The removal of the receivables by Peregrine was fraudulent as well because it did not qualify to take the receivables off the balance sheet under the applicable accounting rules. Once the receivable was sold to the bank, to prevent the banks from learning the receivables were false, Peregrine would purchase the receivables back or pay the receivables themselves, pretending the customer had actually made a payment. When they purchased back the receivable then Peregrine would write off millions of dollars to move ten receivables to ten dollars sense.

1 en receivables were written TOT as acquisition cost of Remedy Corporation with the help of the outside auditor, even though the receivables were totally unconnected to acquisition. Peregrine never disclosed the off-balance-sheet financing in its financial statements and even lie if they happen to mentioned it saying that the sales were without recourse. As part of this fraud skim, Peregrine sold fake invoices to the banks, these invoices were prepared for deals that had not been closed and in some cases never closed, leaving Peregrine with a deficit of several millions of dollars. In June 2001, due to missing their target of days sales outstanding because the receivables were about twenty millions too high, the treasury manager, with senior management ' s approval created a false invoice for nearly twenty million dollars and then submitted it to the bank as a valid receivable; the chief financial officer signed and submitted it to the bank.

Once cash was collected, Peregrines treasury manager would reduce the accounts receivables again by the amount of the collection; in addition to this, Peregrine did tot increased accounts payable to reflect its liability to the banks, and would record the cash as its own, instead of keeping it in trust as mandatory by the banks. This caused cash, receivables and days of sale outstanding to be overstated. Another practice that Peregrine did was to keep open its books after fiscal quarters ended, this way they improperly recorded revenue for the prior quarter, software transactions that were not closed until after the quarter end.

Peregrines executives recorded revenue in a quarter, even when the transaction did not happen for months. Peregrine officers, and sales and

finance personnel probably knew or closed their eyes to these practices; these transactions obviously did not qualify under revenue recognition rules. Peregrine incorrectly accounted for stock options; every quarter the board meeting would be held, at that time, the board of directors would approve the total stock options to be granted to employees before the next board meeting.

Stock was allocated to employees during the quarter, but management would not set a price to the stock until the day after the next quarterly board meeting. The selection of the price was totally fraudulent, Peregrine's stock administrator would look back at the market price to find the lowest price at which Peregrine's stock had sold, then select that lowest cost for the exercise price, this to benefit those who received the stock options.

Under the pertinent accounting rules, any variance between the stock price and exercise price on the grant day, should be recorded as a compensation expense, Peregrine did not do this and understated its compensation expense for about ninety millions. As part of covering up the fraud they were perpetrating, Peregrine did not keep their accounting books and records. The company did not have detail accounts receivable sub ledger that would reconcile to the general ledger. They failed to maintain a detail sales journal that would match the general ledger.

Peregrine did not use the accounting system they had in place to track the license revenue, which it make no sense; instead they would record the license revenue on a excel sheet call the " revenue report". Then at the end of the period, normally each quarter, accountants would enter a manual entry

to make the general ledger tie the revenue report. The fraud involved the participation and of the top senior management at Peregrine, the outside auditor, and some of the customers.

Major involvement was the part that the outside auditor played. The auditor allowed Peregrine to record revenue Improperly, also, ten auditor Knew Tanat the financial statements related to the 2001 fiscal year were materially misstated and he did not do anything to prevent those financial from being release to the public. Arthur Andersen, the accounting firm in charge of audit Peregrines financial statement, gave an unqualified opinion to Peregrines fiscal 2001 financial statements.

In court, Peregrines former CEO, explained how he had headed over an accounting scheme that lasted for years. He also said that “ the sham business deals had mounted, quarter after quarter, until Peregrine became a runaway train of corporate corruption. ” Peregrine filed for Chapter 11 bankruptcy protection and blamed is failure on Arthur Andersen, their outside auditors; Peregrine blamed the audit firm of fraud, corporate negligence and failure in its auditing and accounting duties. Arthur Anderson officials responded “ This looks smells and tastes like a hysterical board of directors looking for a scapegoat to cover up their failures and the failures of their handpicked executives”, said Patrick Torn, spokesperson for Arthur Andersen. “ This is really outrageous, even in this season of blaming auditors. ” All charges against Arthur Andersen, ALP audit partner (Daniel Francis Actual) with relation to Peregrine Systems, Inc. , were dismissed.

Defense lawyers argued that their client did not have any motive to participate in the fraud, because the audit it's performed in a client-controlled environment. I think at the end of the day, the final victims here are the shareholders, all the people that lost their life-time savings to a corrupt and unscrupulous management team. How can we avoid this from happen again? I think executive's compensation's should not be tie to the company's financial results, this way they (executives) would be less enticed to alter the books for their own benefit.