

DELL INC
Form 10-Q/A
October 30, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q/A

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended May 5, 2006
or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number: 0-17017

Dell Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

74-2487834

(I.R.S. Employer Identification No.)

One Dell Way

Round Rock, Texas 78682

(Address of Principal Executive Offices) (Zip Code)

(512) 338-4400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of the close of business on October 19, 2007, 2,235,866,516 shares of common stock, par value \$.01 per share, were outstanding.

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Certification of Chairman and CEO Pursuant to Section 302

Certification of Vice Chairman and CFO Pursuant to Section 302

Certifications Pursuant to Section 906

Special Note

The Audit Committee of our Board of Directors recently completed an independent investigation into certain accounting and financial reporting matters. As a result of issues identified in that investigation, as well as issues identified in additional reviews and procedures conducted by management, the Audit Committee, in consultation with management and PricewaterhouseCoopers LLP, our independent registered public accounting firm, concluded on August 13, 2007 that our previously issued financial statements for Fiscal 2003, 2004, 2005, and 2006 (including the interim periods within those years), and the first quarter of Fiscal 2007, should no longer be relied upon because of certain accounting errors and irregularities in those financial statements. Accordingly, we have restated our previously issued financial statements for those periods. Restated financial information is presented in this report, as well as in our Annual Report on Form 10-K for Fiscal 2007. For a discussion of the investigation, the accounting errors and irregularities identified, and the adjustments made as a result of the restatement, see Note 2 of Notes to Condensed Consolidated Financial Statements included in Part I Item 1 Financial Statements.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****DELL INC.****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**
(in millions)

	May 5, 2006 As Restated (unaudited)	February 3, 2006 As Restated
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,889	\$ 7,054
Short-term investments	1,579	2,016
Accounts receivable, net	4,332	4,082
Financing receivables, net	1,455	1,366
Inventories	651	588
Other	2,633	2,688
Total current assets	17,539	17,794
Property, plant, and equipment, net	2,072	1,993
Investments	2,690	2,686
Long-term financing receivables, net	255	325
Other non-current assets	508	454
Total assets	\$ 23,064	\$ 23,252
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	\$ 57	\$ 65
Accounts payable	10,109	9,868
Accrued and other	6,500	6,240
Total current liabilities	16,666	16,173
Long-term debt	595	625
Other non-current liabilities	2,519	2,407
Total liabilities	19,780	19,205
Commitments and contingencies (Note 9)		

Redeemable common stock and capital in excess of \$.01 par value; 1 share issued and outstanding (Note 12)		39	
Stockholders' equity:			
Preferred stock and capital in excess of \$.01 par value; shares issued and outstanding: none			
Common stock and capital in excess of \$.01 par value; shares authorized: 7,000; shares issued: 2,825 and 2,818, respectively; shares outstanding: 2,279 and 2,330, respectively		9,694	9,503
Treasury stock at cost: 546 and 488 shares, respectively		(19,698)	(18,007)
Retained earnings		13,475	12,699
Accumulated other comprehensive loss		(226)	(101)
Other			(47)
Total stockholders' equity		3,245	4,047
Total liabilities and equity	\$	23,064	\$ 23,252

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**DELL INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(in millions, except per share amounts; unaudited)**

	Three Months Ended	
	May 5, 2006	April 29, 2005
	As Restated	As Restated
Net revenue	\$ 14,320	\$ 13,300
Cost of net revenue ⁽¹⁾	11,812	10,848
Gross margin	2,508	2,452
Operating expenses:		
Selling, general, and administrative ⁽¹⁾	1,414	1,206
Research, development, and engineering ⁽¹⁾	129	109
Total operating expenses	1,543	1,315
Operating income	965	1,137
Investment and other income, net	54	51
Income before income taxes	1,019	1,188
Income tax provision	243	280
Net income	\$ 776	\$ 908
Earnings per common share:		
Basic	\$ 0.34	\$ 0.37
Diluted	\$ 0.33	\$ 0.36
Weighted-average shares outstanding:		
Basic	2,297	2,456
Diluted	2,318	2,515

(1) Cost of revenue and operating expenses for the three month period ended May 5, 2006 include stock-based compensation expense pursuant to Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*. See Note 6 of Notes to Condensed Consolidated Financial Statements for additional information.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**DELL INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
(in millions, unaudited)

	Three Months Ended	
	May 5,	April 29,
	2006	2005
	As	As
	Restated	Restated
Cash flows from operating activities:		
Net income	\$ 776	\$ 908
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	106	90
Stock-based compensation	113	4
Excess tax benefits from stock-based compensation	(32)	
Tax benefits from employee stock plans		32
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	14	(8)
Other	25	16
Changes in:		
Operating working capital	(36)	130
Non-current assets and liabilities	58	102
Net cash provided by operating activities	1,024	1,274
Cash flows from investing activities:		
Investments:		
Purchases	(3,070)	(124)
Maturities and sales	3,548	2,249
Capital expenditures	(187)	(143)
Net cash provided by investing activities	291	1,982
Cash flows from financing activities:		
Repurchase of common stock	(1,691)	(2,000)
Issuance of common stock under benefit plans	138	169
Excess tax benefits from stock-based compensation	32	
Other	(13)	(14)
Net cash used in financing activities	(1,534)	(1,845)
Effect of exchange rate changes on cash and cash equivalents	54	(12)
Net (decrease) increase in cash and cash equivalents	(165)	1,399
Cash and cash equivalents at beginning of period	7,054	4,479

Cash and cash equivalents at end of period	\$ 6,889	\$ 5,878
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)**

NOTE 1 Basis of Presentation

Basis of Presentation The accompanying condensed consolidated financial statements of Dell Inc. (Dell) should be read in conjunction with the consolidated financial statements and accompanying notes filed with the U.S. Securities and Exchange Commission (SEC) in Dell s Annual Report on Form 10-K for the fiscal year ended February 3, 2006. The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments of a normal recurring nature, as well as all adjustments discussed in Note 2, Audit Committee Independent Investigation and Restatement, considered necessary to fairly state the financial position of Dell and its consolidated subsidiaries at May 5, 2006 and February 3, 2006 and the results of its operations and its cash flows for the three month periods ended May 5, 2006 and April 29, 2005.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in Dell s condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from those estimates.

Dell is currently a partner in Dell Financial Services L.P. (DFS), a joint venture with CIT Group, Inc. (CIT). The joint venture allows Dell to provide its customers with various financing alternatives. Dell consolidates DFS financial results in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R (FIN 46R) as Dell is the primary beneficiary. See Note 7 of Notes to Condensed Consolidated Financial Statements.

Stock-Based Compensation Effective February 4, 2006, Dell adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) using the modified prospective transition method, which does not require revising the presentation in prior periods for stock-based compensation. Under this transition method, stock-based compensation expense for the first quarter of Fiscal 2007 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested at, February 4, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted after February 3, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Dell recognizes this compensation expense net of an estimated forfeiture rate over the requisite service period of the award, which is generally the vesting term of five years for stock options and five-to-seven years for restricted stock awards. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123(R) and the valuation of share-based payments for public companies. Dell has applied the provisions of SAB 107 in its adoption of SFAS 123(R). See Note 6 of Notes to Condensed Consolidated Financial Statements for further discussion on stock-based compensation.

Prior to the adoption of SFAS 123(R), Dell measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). Dell applied the disclosure provisions of SFAS 123 such that the fair value of employee stock-based compensation was disclosed in the notes to its financial statements. Under APB 25, when the exercise price of Dell s employee stock options equaled the market price of the underlying stock at the date of the grant, no compensation expense was recognized.

Recently Issued Accounting Pronouncements In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Instruments* (SFAS 155), which is an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and SFAS No. 140,

Table of Contents**DELL INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)**

Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125 (SFAS 140). SFAS 155 allows Dell to elect to account for financial instruments with embedded derivatives as a whole on a fair value basis, instead of bifurcating the derivative from the host financial instrument. This statement also requires Dell to evaluate its interest in securitized financial assets to identify any freestanding derivatives and embedded derivatives, and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event after the beginning of Dell's Fiscal 2008. Dell determined that its retained interest in securitized assets contains embedded derivatives and elected to account for the entire asset on a fair value basis. The fair value basis did not have a material effect on Dell's results of operations, financial position, or cash flows.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140 (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability is initially measured at fair value; however, an entity may elect the amortization method or fair value method for subsequent reporting periods. SFAS 156 is effective beginning Dell's Fiscal 2008. Adoption of SFAS 156 did not have a material effect on Dell's results of operations, financial position, or cash flows.

In June 2006, the Emerging Issues Task Force reached a consensus on Issue No. 06-3, *Disclosure Requirements for Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions* (EITF 06-3). The consensus allows an entity to choose between two acceptable alternatives based on their accounting policies for transactions in which the entity collects taxes on behalf of a governmental authority, such as sales taxes. Under the gross method, taxes collected are accounted for as a component of revenue with an offsetting expense. Conversely, the net method excludes such taxes from revenue. Companies are required to disclose the method selected pursuant to APB Opinion No. 22, *Disclosure of Accounting Policies*. If such taxes are reported gross and are significant, companies are required to disclose the amount of those taxes. The guidance should be applied to financial reports through retrospective application for all periods presented, if amounts are significant, for interim and annual reporting periods beginning after December 15, 2006, which is Dell's Fiscal 2008. Dell records revenue net of such taxes.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. Dell adopted this Interpretation in the first quarter of Fiscal 2008, and this adoption resulted in a decrease to stockholders' equity of approximately \$62 million. In addition, consistent with the provisions of FIN 48, Dell changed the classification of \$1.1 billion of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 addresses the process of quantifying financial statement misstatements; however, it does not address how to assess materiality in interim financial statements. SAB 108 establishes the dual approach for the evaluation of the impact of financial statement misstatements. SAB 108 was effective for Dell's Fiscal 2007. There was no impact on Dell's results of

operations, financial position, or cash flows due to the adoption of SAB 108. However, this guidance was considered in the determination by Dell to restate its previously issued financial statements as discussed in Note 2 of Notes to Condensed Consolidated Financial Statements.

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DELL INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for assets and liabilities measured at fair value. SFAS 157 applies to existing accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by Dell beginning in the first quarter of Fiscal 2009. Management is currently evaluating the impact that SFAS 157 may have on Dell's results of operations, financial position, and cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value with the changes in fair value recognized in earnings at each subsequent reporting date. SFAS 159 provides an opportunity to mitigate potential volatility in earnings caused by measuring related assets and liabilities differently, and it may reduce the need for applying complex hedge accounting provisions. If elected, SFAS 159 is effective for fiscal years beginning after November 15, 2007, which is Dell's Fiscal 2009. Management is currently evaluating the impact that this statement may have on Dell's results of operations and financial position, and has yet to make a decision on the elective adoption of SFAS 159.

Reclassifications To maintain comparability among the periods presented, Dell has revised the presentation of certain prior period amounts reported within the Notes to Condensed Consolidated Financial Statements. For further discussion regarding the presentation of service obligations honored, see Note 8 of Notes to Condensed Consolidated Financial Statements.

NOTE 2 Audit Committee Independent Investigation and Restatement

Background and Scope of the Investigation

In August 2005, the Division of Enforcement of the SEC initiated an inquiry into certain of Dell's accounting and financial reporting matters and requested that Dell provide certain documents. Over the course of several months, Dell produced documents and provided information in response to the SEC's initial request and subsequent requests.

In June 2006, the SEC sent Dell an additional request for documents and information that appeared to expand the scope of the inquiry, with respect to both issues and periods. As documents and information were collected in response to this additional request, Dell's management was made aware of information that raised significant accounting and financial reporting concerns, including whether accruals, reserves, and other balance sheet items had been recorded and reported properly. After evaluating this information and in consultation with PricewaterhouseCoopers LLP, Dell's independent registered public accounting firm, management determined that the identified issues warranted an independent investigation and recommended such to the Audit Committee of Dell's Board of Directors.

On August 16, 2006, the Audit Committee, acting on management's recommendation, approved the initiation of an independent investigation. The Audit Committee engaged Willkie Farr & Gallagher LLP (Willkie Farr) to lead the investigation as the independent legal counsel to the Audit Committee. Willkie Farr in turn engaged KPMG LLP (KPMG) to serve as its independent forensic accountants.

The scope of the investigation was determined by Willkie Farr, in consultation with the Audit Committee and KPMG. The investigation involved a program of forensic analysis and inquiry directed to aspects of Dell's accounting and financial reporting practices throughout the world, and evaluated aspects of its historical accounting and financial reporting practices since Fiscal 2002 and, with respect to certain issues, prior fiscal years.

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DELL INC.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)**

Summary of Investigation Findings

The investigation raised questions relating to numerous accounting issues, most of which involved adjustments to various reserve and accrued liability accounts, and identified evidence that certain adjustments appear to have been motivated by the objective of attaining financial targets. According to the investigation, these activities typically occurred in the days immediately following the end of a quarter, when the accounting books were being closed and the results of the quarter were being compiled. The investigation found evidence that, in that timeframe, account balances were reviewed, sometimes at the request or with the knowledge of senior executives, with the goal of seeking adjustments so that quarterly performance objectives could be met. The investigation concluded that a number of these adjustments were improper, including the creation and release of accruals and reserves that appear to have been made for the purpose of enhancing internal performance measures or reported results, as well as the transfer of excess accruals from one liability account to another and the use of the excess balances to offset unrelated expenses in later periods. The investigation found that sometimes business unit personnel did not provide complete information to corporate headquarters and, in a number of instances, purposefully incorrect or incomplete information about these activities was provided to internal or external auditors.

The investigation identified evidence that accounting adjustments were viewed at times as an acceptable device to compensate for earnings shortfalls that could not be closed through operational means. Often, these adjustments ranged from several hundred thousand to several million dollars, in the context of a company with annual revenues ranging from \$35.3 billion to \$55.8 billion and annual net income ranging from \$2.0 billion to \$3.6 billion for the periods in question. The errors and irregularities identified in the course of the investigation revealed deficiencies in Dell's accounting and financial control environment, some of which were determined to be material weaknesses, that require corrective and remedial actions. For a description of the control deficiencies identified by management as a result of the investigation and Dell's internal reviews described below, as well as management's plan to remediate those deficiencies, see Part I Item 4 Controls and Procedures.

Other Company Identified Adjustments

Concurrently with the investigation, Dell also conducted extensive internal reviews for the purpose of the preparation and certification of Dell's Fiscal 2007 financial statements and its assessment of internal controls over financial reporting. Dell's procedures included expanded account reviews and expanded balance sheet reconciliations to ensure all accounts were fully reconciled, supported, and appropriately documented. Dell also implemented improvements to its quarterly and annual accounting close process to provide for more complete review of the various business unit financial results.

Restatement Adjustments

As a result of the issues identified in the Audit Committee independent investigation, as well as issues identified in additional reviews and procedures conducted by management, the Audit Committee, in consultation with management and PricewaterhouseCoopers LLP, concluded on August 13, 2007 that Dell's previously issued financial statements for Fiscal 2003, 2004, 2005, and 2006 (including the interim periods within those years), and the first quarter of Fiscal 2007, should no longer be relied upon because of certain accounting errors and irregularities in those financial statements. Accordingly, Dell has restated its previously issued financial statements for those periods. Restated

financial information is presented in this report, as well as in Dell's Annual Report on Form 10-K for Fiscal 2007.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)**

The nature of the restatement adjustments and the impact of the adjustments for the three-month period ended May 5, 2006 are shown in the following table:

**Three Month Period Ended May 5, 2006
Adjustments
Revenue**