UNITED STATES OF AMERICA Before the SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933 Release No. 8815 / June 29, 2007

SECURITIES EXCHANGE ACT OF 1934 Release No. 55982 / June 29, 2007

ACCOUNTING AND AUDITING ENFORCEMENT Release No. 2626 / June 29, 2007

ADMINISTRATIVE PROCEEDING File No. 3-12673

In the Matter of

CVS CAREMARK CORPORATION, PHILIP C. GALBO, AND LARRY SOLBERG

Respondents.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASEAND-DESIST PROCEEDINGS PURSUANT
TO SECTION 8A OF THE SECURITIES
ACT OF 1933, SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND RULE 102(e) OF THE
COMMISSION'S RULES OF PRACTICE,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASEAND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against CVS Caremark Corporation ("CVS"), Philip C. Galbo ("Galbo"), and Larry Solberg, CPA ("Solberg") (collectively, "Respondents") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and, as to Respondent Solberg, Rule 102(e)(ii) of the Commission's Rules of Practice. ¹

¹ Rule 102(e)(1)(ii) provides, in pertinent part, that:

In anticipation of the institution of these proceedings, each of the Respondents has submitted an Offer of Settlement (collectively, the "Offers") which the Commission has determined to accept.² Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

A. SUMMARY

This case concerns incorrect accounting by CVS, a national chain of pharmacy and retail merchandise stores and a pharmaceutical benefits management company, for a transaction (the "Transaction") that senior executive Phil Galbo negotiated and the accounting for which Larry Solberg approved. As accounted for, the book value of the excess plush toy inventory, such as seasonal stuffed animals, was not reduced in connection with the Transaction. As a result of recording the Transaction in this manner, CVS materially overstated its pretax earnings for the third quarter of 2000 by approximately \$18.1 million (approximately \$10.8 million after tax), or approximately 7% of net income for the third quarter of 2000.

During the late spring and summer of 2000, Galbo and Solberg became aware that CVS was carrying the plush toy inventory on its books at \$32 million, a value higher than \$13.9 million, the inventory's approximate market value at the time. Instead of writing down the value of the inventory to market value, CVS entered into the Transaction with a barter company pursuant to which CVS contracted to exchange the plush toy inventory for credits with a face value of \$42.5 million. CVS then replaced the \$32 million toy inventory on its books with the credits at a value of \$42.5 million.

The Commission may ... deny, temporarily or permanently, the privilege of appearing or practicing before it ... to any person who is found ... to have engaged in ... improper professional conduct.

² As part of a final resolution of the Commission's claims against them, Galbo and Solberg have also agreed to consent to the entry of a district court judgment ordering Galbo to pay a civil monetary penalty of \$30,000 and Solberg to pay a civil monetary penalty of \$30,000.

Rather than exchange a set of goods or services with CVS, the barter company received no goods or services from CVS. It received \$12.5 million in cash. Under the terms of the deal, the barter company transferred the \$42.5 million in credits and CVS liquidated the inventory in its capacity as agent for the barter company while guaranteeing the barter company \$12.5 million. CVS valued the credits on its books at their full face value of \$42.5 million.

Evidence existed that the credits should not have been recorded at their face value. The credits consisted of \$18.8 million in telecommunications credits and \$23.7 million of credits with the barter company. Although CVS could have theoretically applied the telecommunications credits to pay its own telecommunications bills, CVS used a different telecommunications provider, thereby making the credits harder for CVS to utilize, and arguably of lesser value. The terms of the Transaction also were such that CVS could not use the \$23.7 million in barter company credits alone to purchase more goods from the barter company. Rather, the terms of the barter credit agreement were such that the ratio of barter credits in each transaction would vary from transaction to transaction, subject to mutual agreement between CVS and the barter company, but would generally be a 60-75% cash and 25-40% barter credit configuration.

Finally, even if CVS had properly transferred the toy inventory to the barter company, Generally Accepted Accounting Principles ("GAAP") required (a) that the toys be written down to their fair market value prior to entering the Transaction and (b) that CVS disclose the existence and certain details of the Transaction. CVS neither recorded the required write-down in the value of the toys nor properly disclosed the Transaction in its financial statements. Failing to reduce the book value of the toys to their market value had a material effect on CVS's financial results for the third quarter of 2000 (although not on CVS's financial results for the 2000 fiscal year).

B. RESPONDENTS

- 1. **CVS Caremark Corporation** is a Delaware corporation headquartered in Woonsocket, Rhode Island. Its primary business is the operation of over 6,200 retail stores that sell pharmacy and consumer products and the operation of a pharmaceutical benefits management company headquartered in Nashville, Tennessee. Its shares are registered under Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. CVS files periodic reports with the Commission pursuant to the Exchange Act. For the year 2000, its fiscal year ended December 30 and its fiscal third quarter ended September 30.
- 2. **Philip C. Galbo**, age 56, is a resident of Gladwyn, Pennsylvania. Galbo, who is not an accountant, was treasurer of CVS during the relevant period.
- 3. **Larry Solberg**, age 58, is a resident of Holmes Beach, Florida, and former controller of CVS. He is a certified public accountant whose license in the state of Minnesota is inactive. He was the principal accounting officer at CVS during the relevant period.

C. FACTS

CVS Discovers Sales of Excess Plush Toy Inventory Are Down, Which Poses a Threat to the Company's Achieving Its Financial Goals

- 1. At year-end 1999, CVS determined that its plush toys should be held over for the following year at full book value. Subsequently, in April and May 2000, CVS analyzed the status of its plush toy programs, which it had determined to terminate. The analysis revealed, among other things, that projected sales were less than the cost at which CVS was carrying the toys on its books and that the rate at which certain lines of plush toys were selling was low in comparison to historical rates and sales rates on other products. One then CVS vice president (the "CVS vice president") informed Solberg, the then controller, that poor sales were a potential threat to CVS achieving its gross margin goals for 2000.
- 2. During the summer of 2000, the value of the plush toys continued to decline according to some internal reports. Both Solberg and Galbo were sent a written analysis on August 25, 2000 that projected sales of \$13.9 million for the \$32 million (at cost) of plush toy inventory. In addition, in September, CVS agreed to liquidate 18% of the inventory at fourteen cents per dollar of cost. Ultimately, CVS realized approximately \$12 million on the liquidation of the plush toy inventory.
- 3. Throughout the summer of 2000, Solberg received documents indicating several threats, including the plush toys, to CVS achieving its financial goals. Galbo stated to his contact at the barter company that CVS's independent outside auditors had indicated that if the plush toy inventory were not sold, CVS may be facing some possible write-downs.

CVS Does Not Take a Charge to Reflect the Toys' Impaired Value, But Instead Enters Into the Transaction

4. To address the potential plush toy issue, Galbo, who was not involved in accounting for the Transaction, began negotiating the Transaction on CVS's behalf in or around May 2000. Galbo received an email from another then CVS executive which stated that avoiding markdowns on the plush toys through the proposed Transaction was "a major element of fixing [CVS's] significant profit gap." The value of the toys as reflected on CVS's books was \$32 million, but reports circulated to Galbo and Solberg indicated that their actual fair market value was much less. Solberg also reviewed and presented periodic reports to senior management that suggested the failure to close the Transaction was a potential threat to CVS's financial goals. Indeed, some of these reports, generated in September 2000, stated that there was "no margin for error" in achieving the consensus target for the third quarter 2000 and that management was to continue to "manage and monitor" a number of risk areas, including the proposed Transaction. Galbo received at least one such copy of the September 2000 report.

CVS Exchanges Credits With a \$42.5 Million Face Value for \$12.5 Million Cash, And Accounts for the Transaction As If CVS Had Transferred the Risks and Rewards of the Toy Inventory

- 5. On the last business day of CVS's third quarter 2000, after evaluating and presenting various transaction alternatives involving multiple entities, Galbo executed a letter of intent concerning the plush toy inventory with a barter company with which CVS had previously done business. Pursuant to this Transaction, CVS paid the barter company \$12.5 million (referred to as a guaranteed liquidation fee) in return for (a) a coupon entitling CVS to \$18.8 million of phone services with a vendor that CVS did not use and (b) barter credits entitling CVS to \$23.7 million of discounts off purchases of future unspecified goods and services from the barter company. In the Transaction, CVS also undertook to transfer title of the toys to the barter company, but the agreement left CVS with the risks and rewards of, and responsibility for, selling the plush toys, and CVS at all times retained physical possession of them.³
- 6. Nonetheless, CVS accounted for the Transaction as if it had transferred the toys to the barter company. Through a series of journal entries, CVS effectively replaced the \$32 million plush toy inventory with coupon/barter credit inventory at its face value of \$42.5 million. The effect of replacing toy inventory with coupon/credit inventory was that - at least on its books - CVS no longer owned a plush toy inventory that had a market value that was less than its book value. Accordingly, it did not take the appropriate impairment charge. In addition, on September 30, 2000, CVS reversed \$3.5 million of markdown expenses it had taken on a portion of the plush toy inventory during the summer months. By doing so, CVS not only retained the benefit of the cash generated by the summer sales of some of this inventory at marked down prices, but also, for purposes of markdown expense, treated the previously sold toys as if they had been exchanged to the barter company in return for credits. Solberg was aware of the reversal of markdown expense, but he did not know that a portion of the markdown reversal had been applied to previously sold toys. In connection with the year-end audit for 2000, Solberg discussed the Transaction with CVS's independent outside auditors. Based on the internal reports he received earlier in the year, Solberg should have known of the decline in the toys' value relative to their cost and discussed that with the independent outside auditors, but he did not.

Galbo and Solberg Should Have Known That the Toys Should Have Been Written Down at the End of the Third Quarter

7. Both Galbo and Solberg should have known that not taking an impairment charge to the plush toy inventory was incorrect. Each was exposed to red flags that signaled the error of not taking that charge. For example, each reviewed the contracts that showed that CVS retained responsibility for liquidating the plush toys, retained the risk of their loss, and retained to some extent the rewards of their sale. Moreover, based on the internal reports that were circulated to them, each should have known that CVS's internal estimates of plush toy sales were far less than the pre-

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³ Although CVS referred to the Transaction as a "barter transaction," in economic substance it involved a payment of cash for credits and was not an exchange of non-monetary goods or services.

September 2000 book value and far less than the combined face value of the credits and phone services coupon received from the barter company. Just days prior to the Transaction, Galbo wrote a memo which Solberg received, in which he acknowledged, "We need to cover \$41.5 MM of margin with only \$12MM of inventory market value." Indeed, the CVS vice president, who was not an accountant, expressed to Solberg and Galbo that she thought the Transaction was "a little screwy" because it seemed to allow CVS not to take markdowns to inventory. The CVS vice president also expressed to Solberg her lack of understanding of how anyone would pay CVS so much for something the CVS vice president could not see value in.

- 8. With respect to Solberg, there were other red flags. The CVS vice president asked Solberg whether it would not be more appropriate to reduce the book value of the plush toy inventory first and then engage in the Transaction. Solberg should have known that CVS had not yet identified any uses for the barter credits or phone services coupon, should have known CVS had no experience retrading credits or coupons to third parties, and received other information casting doubts on the idea that the coupon and credits were worth their face value.
- 9. Galbo, too, was exposed to a number of red flags from which he should have known that the credits were not worth their face value. For example, the phone service coupon was issued by a telecommunications provider CVS could not use due to its contractual commitments to its own provider and therefore would need to be retraded to achieve value for CVS. Although Galbo was reassured by his barter company contact that the telephone credits could be placed, Galbo knew that (a) CVS had no history retrading coupons, (b) no CVS vendor had committed to accepting the coupon, and (c) only four of CVS's top fifty vendors were current users of the telecom provider (and those four in very small amounts). CVS nevertheless recorded the coupon at face value. Furthermore, in July 2000, Galbo acknowledged that absent assurance of current or future vendors' acceptance of them, trade credits offered by a different barter company would most likely have to be "significantly discounted" if CVS elected to pursue a transaction with that company. Though no such guarantee existed with respect to the barter credits that CVS ultimately acquired from another company, and although his contact at that barter company informed Galbo that it did not normally issue barter credits and noted some potential risks of barter credits versus a direct asset exchange, CVS also recorded the barter credits at face value. CVS ultimately utilized a majority of the credits and wrote down the balance in 2003.

Galbo and Solberg Cause CVS to File False Financial Results for the Third Quarter 2000 That Are Repeated in Year-End Results And Incorporated by Reference in Filings Related to a June 2001 Offering

10. As a result of the foregoing, CVS did not provide in its financial results for the third quarter of 2000 for the reduction in value of the toys from their book value of \$32 million to their projected market value of \$13.9 million. Accordingly, its pretax earnings for the third quarter were overstated by approximately \$18.1 million (the amount of the impairment), and after tax earnings were overstated by approximately \$10.8 million, or approximately 7% of net income. These overstated results were also made part of CVS's filing for the year-end 2000 which were in turn incorporated by reference in filings in connection with a June 2001 secondary offering of securities by CVS. As principal accounting officer, Solberg signed the year-end 2000 filings.

11. Both Galbo and Solberg received bonuses for year-end 2000 that were tied to CVS's financial results. The failure to reflect the reduction of the value of the toys therefore caused each to receive a higher bonus than he otherwise would have. In addition, Galbo received additional discretionary bonuses explicitly tied in part to work on the Transaction and its benefit to CVS's bottom line.

D. VIOLATIONS

- 1. Section 17(a)(2) of the Securities Act prohibits a person, in the offer or sale of a security, "directly or indirectly ... to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading." Section 17(a)(2) has no scienter requirement. *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980). Negligent conduct can violate Section 17(a)(2). *See,e.g, SEC v. Hughes Capital Corp.*, 124 F.2d 449, 453 (3d Cir. 1997); *In the Matter of Raymond James Financial Services, Inc.*, Exchange Act Release No. 49234 (Feb. 12, 2004).
- 2. As described above, Solberg violated Section 17(a)(2) by causing untrue statements of fact concerning third quarter 2000 results to be incorporated by reference in filings related to CVS's June offering. Although Solberg should have been aware that CVS's financial accounting for the Transaction was incorrect and that CVS should have written the plush toys down to their market value in the third quarter of 2000, Solberg reviewed the erroneous accounting for the Transaction, which was incorporated by reference in filings related to the June 2001 offering of securities.
- 3. As described above, Galbo violated Section 17(a)(2) by causing untrue statements of fact concerning third quarter 2000 results to be incorporated by reference in filings related to CVS's June offering. Although Galbo should have been aware that CVS's financial accounting for the Transaction was incorrect and that CVS should have written the plush toys down to their market value in the third quarter of 2000, Galbo nevertheless negotiated the Transaction, the erroneous accounting for which was incorporated by reference in filings related to the June 2001 offering of securities.
- 4. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.,* 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979).
- 5. As discussed above, Solberg caused CVS to file a false and misleading quarterly report with the Commission that misrepresented the financial results of CVS, overstating operating income and earnings. By his conduct described above, Solberg caused CVS's violations of Section

13(a) of the Exchange Act and Rules 13a-l and 13a-13 thereunder, and CVS violated Section 13(a) of the Exchange Act and Rules 13a-l and 13a-13 thereunder.

- 6. As discussed above, Galbo caused CVS to file a false and misleading quarterly report with the Commission that misrepresented the financial results of CVS, overstating operating income and earnings. By his conduct described above, Galbo caused CVS's violations of Section 13(a) of the Exchange Act and Rules 13a-l and 13a-13 thereunder, and CVS violated Section 13(a) of the Exchange Act and Rules 13a-l and 13a-13 thereunder.
- 7. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.
- 8. As a result of the actions taken by Solberg as described above, CVS's books and records reflecting the transactions and dispositions of its plush toy assets were not accurate. Based on the conduct described above, Solberg caused CVS's violation of Section 13(b)(2)(A) of the Exchange Act, and CVS violated Section 13(b)(2)(A) of the Exchange Act.
- 9. As a result of the actions taken by Galbo as described above, CVS's books and records reflecting the transactions and dispositions of its plush toy assets were not accurate. Based on the conduct described above, Galbo caused CVS's violation of Section 13(b)(2)(A) of the Exchange Act.
- 10. Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in relevant part, that the Commission may deny the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct, which includes negligent conduct consisting of "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." Rule 102(e)(1)(iv)(A)(2). As described above, Solberg engaged in repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

E. FINDINGS

- 1. Based on the foregoing, the Commission finds that Solberg (a) violated Section 17(a)(2) of the Securities Act; and (b) caused CVS's violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 13a-1 and 13a-13 promulgated thereunder.
- 2. Based on the foregoing, the Commission finds that Galbo (a) committed a violation of Section 17(a)(2) of the Securities Act; and (b) caused CVS's violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 13a-1 and 13a-13 promulgated thereunder.
- 3. Based on the foregoing, the Commission finds that CVS committed violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 13a-l and 13a-13 promulgated thereunder.

4. Based on the foregoing, the Commission finds that Solberg engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in each of the Respondents' Offers of Settlement.

Accordingly, it is hereby ORDERED, effective immediately, that:

- A. Respondents Solberg and Galbo shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act, and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 13a-1 and 13a-13 promulgated thereunder.
- B. Respondent Solberg is denied the privilege of appearing or practicing before the Commission as an accountant.
- C. After one year from the date of this order, Respondent Solberg may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:
- 1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent Solberg's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
- 2. an independent accountant. Such an application must satisfy the Commission that:
- (a) Respondent Solberg, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;
- (b) Respondent Solberg, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that Respondent Solberg will not receive appropriate supervision;

- (c) Respondent Solberg has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and
- (d) Respondent Solberg acknowledges his responsibility, as long as Respondent Solberg appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.
- D. The Commission will consider an application by Respondent Solberg to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent Solberg's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.
- E. Respondent CVS shall cease and desist from committing or causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 13a-1 and 13a-13 promulgated thereunder.
- F. IT IS FURTHERED ORDERED that Respondent Galbo shall, within ten days of the entry of this Order, pay disgorgement of \$22,000 and prejudgment interest of \$8,727.62 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States Treasury; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Galbo as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John T. Dugan, Associate District Administrator, Division of Enforcement, Securities and Exchange Commission, Boston District Office, 33 Arch Street, 23rd Floor, Boston MA 02110.
- G. IT IS FURTHERED ORDERED that Respondent Solberg shall, within ten days of the entry of this Order, pay disgorgement of \$16,000 and prejudgment interest of \$6,476.21 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States Treasury; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Solberg as a Respondent in these

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proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to John T. Dugan, Associate District Administrator, Division of Enforcement, Securities and Exchange Commission, Boston District Office, 33 Arch Street, 23rd Floor, Boston, MA 02110.

By the Commission.

Nancy M. Morris Secretary