U.S. Securities and Exchange Commission

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 8525 / January 24, 2005

Securities Exchange Act of 1934
Release No. 51072 / January 24, 2005

Accounting and Auditing Enforcement
Release No. 2172 / January 24, 2005

Admin. Proc. File No. 3-11799

In the Matter of Daisytek International Corporation, Respondent.	: : : : : : :	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Daisytek International Corporation ("Daisytek," "Company," or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. 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 it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

RESPONDENT

1. **Daisytek**, a Delaware corporation based in Allen, Texas, was previously a NASDAQ listed, Fortune 1000 company. On May 8, 2003, in its Form 8-K, Daisytek reported that it had filed a voluntary petition under Chapter 11 of the U. S. Bankruptcy Code on May 7, 2003. Prior to filing for bankruptcy, Daisytek was engaged in the sale and distribution of office products and computer supplies, both in the United States and internationally, but it currently has only limited business operations. Daisytek's common stock was, until recently, registered under Section 12(g) of the Exchange Act.

EARNINGS MANAGEMENT

2. Daisytek managed improperly its earnings during its fiscal years ended in 2001, 2002, and 2003.[2]

3. For the year ended March 31, 2001, Daisytek reported revenues of $1.01 billion and net income of $11.43 million. For the year ended March 31, 2002, Daisytek reported revenues of $1.19 billion and net income of $10.85 million. For the 9 months ended December 31, 2002, Daisytek reported revenues of $1.33 billion and a net loss of $24.15 million. Daisytek did not file annual financial statements for the year ended March 31, 2003.

4. Daisytek regularly announced earnings forecasts it could not meet, and its inability to meet those forecasts led it to implement a practice known as "booking to budget." The practice involved, on a monthly basis, booking fictitious "budgeted" revenue and expense amounts, based on the earnings forecasts and budgeted expenses, instead of actual revenue and expense amounts.

5. At the end of each quarter, Daisytek closed the gap between its actual results and the "booked to budget" amounts by making large inventory purchases. The large inventory purchases provided the Company with vendor allowances such as rebates, market development funds ("MDF"), and co-op funds, which the Company immediately booked as revenue or as reductions to the cost of goods sold during the quarter.[3] Daisytek thereby instantly inflated reported earnings and appeared more profitable.

6. The large, quarter-end inventory purchases negatively affected Daisytek's liquidity and operations because they typically involved products that were unnecessary for the Company's operations, but on which manufacturers provided large vendor allowances because such products were slow moving. As a result, Daisytek exhausted its capital through purchases of slow-moving products, which hampered its ability to maintain sufficient inventory of its fastest moving "A" products.[4]

7. The quarter-end inventory purchases impaired Daisytek's ability to operate profitably. As a result, the Company needed to make ever-increasing purchases to cover ever-worsening earnings, and the situation spiraled downward. As a result, the Company's liquidity was so negatively affected that its suppliers placed it on credit hold in late 2002 and early 2003. At that point, the Company could neither purchase the inventory it needed to meet customer demands, nor profitably sell its excess inventory of slow-moving products, and its business quickly unraveled, leading to Daisytek's bankruptcy.

INADEQUATE AND MISLEADING DISCLOSURE

8. Daisytek provided false and misleading descriptions about its inventory-purchasing policy in quarterly and annual reports filed with the Commission. For example, Daisytek's Form 10-K for the year ended March 31, 2002 stated: "Our purchases of inventory generally are closely tied to sales and are usually based upon the sales volume of the most recent six to ten week periods;" and "Daisytek manages its inventories held for sale in its core wholesale distribution business by maintaining sufficient quantities of product to achieve high order fill rates while at the same time maximizing inventory turnover rates." In fact, as noted above, many of Daisytek's inventory purchases bore no relation to historical sales or an effort to maximize inventory turnover rates, and were based solely on the Company's need for vendor allowances to meet its earnings forecasts.

9. Daisytek failed to provide material information, in quarterly and annual reports filed with the Commission, about its reliance on vendor allowances or the effects vendor allowances had on its operations. Funds from vendor allowances often exceeded the earnings reported by Daisytek. For example, Daisytek recorded $22 million of vendor allowances in its books for the year ended March 31, 2002, and reported annual net income of $10.85 million in its Form 10-K. The Company did not disclose, however, that a significant portion of its reported earnings came through vendor allowances, as opposed to sales.

IMPROPER ACCOUNTING

10. Daisytek mischaracterized and improperly accounted for vendor allowances by routinely characterizing manufacturer rebates (which should be recognized for accounting purposes when a product is sold through) as MDF and co-op funds (which can be immediately recognized as revenue). This practice allowed the Company to accelerate earnings and improperly recognize millions of dollars of rebates instantly as revenue in the form of MDF and co-op funds.

11. Daisytek also regularly recorded vendor allowances that it knew or was reckless in not knowing were non-existent, or were wholly or partially uncollectible. During early 2002, for example, Daisytek booked $1.7 million in vendor allowances for the production of a catalog, without receiving any commitments from vendors for the $1.7 million (approximately $700,000 of which had to be written off in late 2002). In late 2002, Daisytek wrote off $900,000 in co-op funds that it had previously booked, but for which it had no indication of collectability. On numerous occasions, Daisytek also booked vendor allowances to offset corporate expenses such as office parties, business travel, and community-event sponsorships, without having commitments from vendors to pay for those expenses.

12. Daisytek also under-recorded expenses. For example: (i) when actual expenses exceeded budgeted expenses, the Company repeatedly ignored the actual figures and booked the budgeted figures; (ii) the Company under-stated freight expenses by at least $1.8 million during late 2001 and 2002; and (iii) during 2002, Daisytek failed to recognize the expenses it was incurring to develop a new catalog, although it had recognized non-existent vendor allowances in connection with the production of that catalog.

13. Daisytek also engaged in numerous other accounting improprieties, including: (i) recording receivables without adequate supporting

documentation; (ii) failing to write off uncollectible receivables on a timely basis; and (iii) failing to record adequate inventory reserves.

INTERNAL CONTROL DEFICIENCIES

14. Daisytek failed to devise and maintain a system of internal accounting controls that were sufficient to provide reasonable assurances that its transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets. For example: (i) Daisytek improperly recorded vendor rebates as MDF and co-op funds; and (ii) Daisytek's general ledger contained unsubstantiated journal entries.

SECURITIES OFFERING

15. Daisytek offered and sold securities to its employees in 2001 and 2002 pursuant to S-8 registration statements filed with the Commission, and failed to disclose in connection with those offerings that the Company was managing and inflating earnings as described herein.

FEDERAL SECURITIES LAW VIOLATIONS

16. As a result of the conduct described above, Daisytek violated Section 17(a) of the Securities Act, which prohibits making misstatements or omissions of a material fact in the offer or sale of any securities.

17. As a result of the conduct described above, Daisytek violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

18. As a result of the conduct described above, Daisytek violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 thereunder, which required Daisytek to file information and documents as prescribed by the Commission, including annual and quarterly reports, and to include in those reports any material information as may be necessary to make the required statements in those reports not misleading in light of the circumstances under which the statements were made.

19. As a result of the conduct described above, Daisytek violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

20. As a result of the conduct described above, Daisytek violated Section 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder, which require all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles; and prohibit any person from, directly or indirectly, falsifying or causing to be falsified, any book, record or account.

UNDERTAKINGS

21. Respondent undertakes to cooperate with the Commission's continuing investigation of the matters discussed herein.

22. In determining whether to accept the Offer, the Commission has considered this undertaking.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Daisytek's Offer.

Accordingly, it is hereby ORDERED that:

Respondent Daisytek cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 13a-1, 13a-13, and 13b2-1, and 12b-20 thereunder.

By the Commission.

Jonathan G. Katz
Secretary

Endnotes

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] Daisytek's fiscal year is April 1 through March 31.

[3] Rebates are discounts that manufacturers give based on specific purchases of products. Manufacturers typically make MDF payments to a distributor for the distributor's efforts to create a market for the manufacturer's product (e.g., creating and circulating pamphlets). Co-op funds are very similar to MDF payments, except that a manufacturer may pay co-op funds for a specific activity it directs the distributor to undertake, and MDF funds are for general marketing activities, over which the distributor may have more discretion.

[4] In some cases, the Company had well in excess of a two-year supply of products subject to obsolescence and price decreases. Daisytek, at year-end 2001, reported inventory of $83.6 million; at year-end 2002, $115.4 million; and, for the 9 months ended December 31, 2002, inventory of $190.7 million.

http://www.sec.gov/litigation/admin/33-8525.htm