

## Case A.4

### Sunbeam

Following several quarters of disappointing sales and earnings results, CEO and Chairman Roger Schipke tendered his resignation in April 1996. The company named as Schipke's successor Albert J. Dunlap, chief of Scott Paper Co. and a turnaround specialist nicknamed "Chainsaw Al" because of the cost-cutting measures he typically employed.

Dunlap began his tenure as CEO and chairman by replacing almost all of top management, and then led the company in an aggressive corporate restructuring that included the elimination of half of the company's 12,000 employees and the elimination of 87 percent of Sunbeam's product list. Sunbeam's turnaround was ultimately unsuccessful. CEO and Chairman Dunlap was fired in June 1998.

During October 1998, Sunbeam announced that it would need to make substantial restatements to its prior financial statements in 1996, 1997, and 1997.<sup>434</sup> In February 2001, Sunbeam filed for Chapter 11 bankruptcy protection. In May 2001, the SEC levied fraud charges against several former Sunbeam officials, including former CEO Dunlap.

### Sunbeam's History<sup>435</sup>

The early beginnings of Sunbeam Corporation could be traced back to the Chicago Flexible Shaft Company, founded by John Stewart and Thomas Clark in 1897. Although it was not until 1946 that the company changed its name to Sunbeam, it adopted the name Sunbeam in its advertising shortly after it expanded into manufacturing electrical appliances in 1910.

Successful products in the 1930s included the Sunbeam Mixmaster, a stationary food mixer; the Sunbeam Shavemaster Shaver, the first automatic coffeemaker; and the first pop-up electric toaster. Later appliances included the hair dryer (1949), humidifier (1950), ice crusher (1950), knife sharpener (1950), the Sunbeam Egg Cooker (1950), the Sunbeam Controlled Heat fry pan (1953), and an electric blanket (1955). The company acquired rival household appliance maker Oster in 1960.

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<sup>434</sup> GAO-03-138, Appendix XVII "Sunbeam Corporation," p. 201.

<sup>435</sup> Hoovers Online.

In 1981, Sunbeam was acquired by industrial conglomerate Allegheny International, which fell into bankruptcy in 1988 because of economic difficulties in its other divisions. Michael Price, Michael Steinhardt, and Paul Kazarian bought Allegheny from its creditors in 1990 and named the company Sunbeam-Oster. Kazarian assumed the positions of CEO and chairman. Under Kazarian's leadership, the company paid off its debt, reorganized operations, and cut its workforce dramatically.<sup>436</sup>

The company went public in 1992. Mr. Kazarian was forced out in 1993 and replaced by Roger Schipke, a former manager of General Electric's appliance division. Kazarian was subsequently awarded \$160 million in a lawsuit he filed for being forced out. The company was renamed Sunbeam in 1995. That year, the company faced stagnant product prices and other difficult industry conditions, such as the growth of discount chains. In the face of these conditions, Sunbeam introduced new product lines, made acquisitions, and invested in greater production capacity.<sup>437</sup> After several quarters of disappointing sales and earnings results, Schipke tendered his resignation in April 1996. The company named as Schipke's successor Albert J. Dunlap, chief of Scott Paper Co.

## **Sunbeam in 1996**

Sunbeam Corporation had five major product lines in its domestic operations: household appliances, health care products, personal care and comfort products, outdoor cooking products, and "away from home" business. It also had international sales that accounted for approximately 19 percent of its total net sales.<sup>438</sup>

Household appliances (29 percent of 1996 domestic net sales) included blenders, food steamers, bread makers, rice cookers, coffee makers, toasters, and irons. Examples of health care products (11 percent) were vaporizers, humidifiers, air cleaners, massagers, and blood pressure monitors. Sunbeam's line of personal care and comfort products (21 percent) included shower massagers, hair clipper and trimmers, and electric warming blankets. Some of its major outdoor cooking products (29 percent) were electric, gas, and charcoal grills, and grill accessories. Its "away from home" business (5 percent) marketed clippers and related products for the professional and veterinarian trade, as well as products to commercial and institutional channels.

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<sup>436</sup> Robert Frank and Joann S. Lublin, "Dunlap's Ax Falls—6,000 Times—at Sunbeam," *Wall Street Journal*, November 13, 1996.

<sup>437</sup> *Ibid.*

<sup>438</sup> 1996 10K filing to SEC, Item 1 ("Business").

## Executive Leadership

Chairman and CEO Albert J. Dunlap assumed leadership in 1996. Dunlap invested \$3 million of his own money in Sunbeam shares. “If I make a lot of money here [at Sunbeam]—which I certainly intend to do—then the shareholders will make a lot.... I’m in lockstep with the shareholders.”<sup>439</sup>

Dunlap immediately hired Russell Kersh as Sunbeam’s chief financial officer. Dunlap and Kersh both entered into lucrative three-year employment agreements that gave them strong financial incentives to raise the share price of the company. Dunlap then replaced almost all of top management, and their replacements were each provided with strong financial incentives to improve the company’s share price.<sup>440</sup>

## Corporate Restructuring and Plans for Growth

Under Dunlap’s reign, Sunbeam embarked on an aggressive restructuring that would involve the elimination of half of the company’s 12,000 employees; the sale or consolidation of 39 of its 53 facilities; the divestiture of several lines of businesses, such as its furniture business; the elimination of 87 percent of Sunbeam’s product list; and the replacement of six regional headquarters in favor of a single office in Delray Beach, Florida. “We planned this like the invasion of Normandy.... We attacked every aspect of the business, said Dunlap.”<sup>441</sup>

Dunlap publicly predicted that, as a result of the restructuring, the company would attain operating margins of 20 percent of sales in 1997, and increase its sales by 20 percent, 30 percent, and 35 percent, respectively, in 1997, 1998, and 1999. This meant that the company would have to double its sales to \$2 billion by 1999.<sup>442</sup> Other goals

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<sup>439</sup> Joann S. Lublin and Martha Brannigan. “Sunbeam Names Albert Dunlap as Chief, Betting He Can Pull Off a Turnaround.” *Wall Street Journal*, July 19, 1996, B2.

<sup>440</sup> “Complaint for Civil Injunction and Civil Penalties,” SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, pp. 7–8.

<sup>441</sup> Robert Frank and Joann S. Lublin. “Dunlap’s Ax Falls—6,000 Times—at Sunbeam.” *Wall Street Journal*, November 13, 1996, B1.

<sup>442</sup> SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, pp. 10–11.

were to introduce 30 new products each year domestically, and to triple international sales to \$600 million by 1999.<sup>443</sup>

## Sunbeam's Restructuring Charges

Associated with its operational restructuring, Sunbeam's 1996 results included a pretax charge to earnings of \$337.6 million, which was allocated as follows:<sup>444</sup>

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Restructuring, Impairment, and Other Costs	\$154.9 million
Cost of Goods Sold	\$ 92.3 million
Selling, General, and Administrative (SG&A)	\$ 42.5 million
Estimated Loss from Discontinued Operations	\$ 47.9 million
Total	\$337.6 million

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## Restructuring, Impairment, and Other Costs

The "Restructuring, Impairment, and Other Costs" category included the following cash items: severance and other employee costs (\$43.0 million); lease obligations and other exit costs associated with facility closures (\$12.6 million); and back office outsourcing start-up costs and other costs related to the implementation of the restructuring and growth plan (\$7.5 million). Noncash items in this category (\$91.8 million) were related to asset write-downs for disposals of excess facilities and equipment and noncore product lines; write-offs of redundant computer systems from the administrative back-office consolidations and outsourcing initiatives; and intangible, packaging and other asset write-downs related to exited product lines and SKU reductions.

Importantly, this amount also included approximately \$18.7 million of items that benefited future activities, for example, costs of redesigning product packaging, costs of relocating employees and equipment, and certain consulting fees.<sup>445</sup> Inclusion of these items was not allowed under GAAP.

## Cost of Goods Sold, SG&A, and Estimated Loss from Discontinued Operations

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<sup>443</sup> 1996 10K filing to SEC, Item 1 ("Business").

<sup>444</sup> 1996 10K filing to SEC. Also see 1997 10K SEC filing, Note 8 ("Restructuring, Impairment, and Other Costs").

<sup>445</sup> SEC Accounting and Auditing Enforcement Release No. 1706, January 27, 2003.

As part of its operational restructuring, Sunbeam sold the inventory of its eliminated products to liquidators at a substantial discount. As such, the Cost of Goods Sold portion of the restructuring charge related principally to inventory write-downs and costs of inventory liquidation programs.

The SG&A portion of the restructuring charge related principally to increases in environmental, litigation, and other reserves. The litigation reserve was created for a lawsuit alleging Sunbeam's potential obligation to cover a portion of the cleanup costs for a hazardous waste site. To establish a litigation reserve under GAAP, management must determine that the reserved amount reflects a loss that is probable and able to be reasonably estimated. However, Sunbeam management allegedly failed to take sufficient steps to determine what reserve amount would have been appropriate under GAAP.<sup>446</sup> Finally, the estimated loss from the discontinued operations portion of the restructuring reserve was related to the divestiture of the company's furniture business.<sup>447</sup>

### **Using Excess Reserves to Offset Current Expenses**

In the first quarter of 1997, Sunbeam used \$4.3 million of these restructuring reserves to offset against costs incurred in that period. This improved Sunbeam's 1997 income by approximately 13 percent. Sunbeam failed to disclose this "infrequent item" in its quarterly filing. In the second quarter of 1997, Sunbeam offset \$8.2 million in second quarter costs against the restructuring and other reserves created at year-end 1996, without making the appropriate disclosures. It made a similar offsets of current period expenses in the third and fourth quarters of 1997: \$2.9 million and \$1.5 million, respectively.<sup>448</sup>

### **Restatement of Restructuring Charge**

In November 1998, Sunbeam ultimately restated the pretax restructuring charge from \$337.6 million to \$239.2, which was allocated as follows:<sup>449</sup>

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Restructuring, Impairment, and Other Costs	\$110.1 million
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<sup>446</sup> SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, p. 12.

<sup>447</sup> 1996 10K filed with the SEC.

<sup>448</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>449</sup> Amended 1997 10K filed with the SEC.

Cost of Goods Sold	\$ 60.8 million
Selling, General, and Administrative (SG&A)	\$ 10.1 million
Estimated Loss from Discontinued Operations	\$ 58.2 million
Total	\$239.2 million

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## **Restructuring, Impairment, and Other Costs**

Restructuring, Impairment and Other Costs was restated as follows: severance and other employee costs of \$24.7 million; lease obligations and other exit costs associated with facility closures of \$16.7 million. Noncash items—related to asset write-downs for disposals of excess facilities, and equipment and noncore product lines; write-offs of redundant computer systems from the administrative back-office consolidations and outsourcing initiatives; and intangible, packaging and other asset write-downs related to exited product lines and SKU reductions—totaled \$68.7 million.<sup>450</sup>

## **Cost of Goods Sold, SG&A, and Estimated Loss from Discontinued Operations**

Contributing to the company's need to restate its Cost of Goods Sold expense related to restructuring stemmed from the fact that, in calculating their estimate for year-end inventory of household products, management failed to distinguish excess and obsolete inventory from inventory that was part of their continuing product lines. Thus, the value of Sunbeam's inventory from its continuing household product lines had been understated by \$2.1 million on its balance sheet. Its restatement to its SG&A included a revision of a \$12 million litigation reserve that initially was improperly overstated by at least \$6 million.<sup>451</sup>

## **Sunbeam's Customer Discounts and Other Incentives**

Under GAAP, sales revenue can be recognized only if the buyer assumes the risks and rewards of ownership of merchandise, for example, the risk of damage or physical loss. A sale with a right of return can be recognized as revenue only if the seller takes a reserve against possible future returns. The size of this reserve must be based on history with returns; the sales revenue may not be recorded if no such history exists.

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<sup>450</sup> Amended 1997 10K filed with the SEC.

<sup>451</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

Beginning with the first quarter of 1997, Sunbeam began offering its customers discounts and other incentives if they placed their orders in the current period, rather than holding off until the next period. Sunbeam did not disclose this practice of accelerating expected sales from later periods, however. In the other quarters of 1997, Sunbeam also relied on additional price discounting and other incentives in an attempt to accelerate the recognition of revenue from future periods.<sup>452</sup>

One example of a special arrangement with a customer took place at the end of March 1997, just before the first quarter closed. Sunbeam recognized \$1.5 million in revenue and contributed \$400,000 toward net income from the sale of barbecue grills to a wholesaler. The contract with the wholesaler provided that the wholesaler could return all of the merchandise, with Sunbeam paying all costs of shipment and storage, if it was unable to sell it. In fact, the wholesaler wound up returning all of the grills to Sunbeam during the third quarter of 1997, and the wholesaler incurred no expenses in the transaction.<sup>453</sup>

## **Bill and Hold Sales**

In the second quarter of 1997, Sunbeam recognized \$14 million in sales revenue and contributed over \$6 million toward net income from “bill and hold” sales. By the fourth quarter, Sunbeam was able to recognize \$29 million in revenues and contributed \$4.5 million toward net income in bill and hold sales after it began promoting its bill-and-hold program. Bill and hold sales contributed to 10 percent of the fourth quarter’s revenue.<sup>454</sup>

At year-end 1997, Sunbeam disclosed in its annual filing to the SEC that “the amount of [the] bill and hold sales at December 29, 1997, was approximately 3 percent of consolidated revenues.” It did not disclose that bill and hold sales had been booked primarily in the final quarter to pull revenue from 1998 to 1997.<sup>455</sup>

## **Revenue Recognition Criteria for Bill and Hold Sales**

The SEC had stipulated that the following criteria must be met for revenue to be recognized in bill and hold transactions:<sup>456</sup>

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<sup>452</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>453</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>454</sup> SEC Accounting and Auditing Enforcement Release No. 1394, May 15, 2001.

<sup>455</sup> SEC Accounting and Auditing Enforcement Release No. 1394, May 15, 2001.

- The risks of ownership must have passed to the buyer.
- The buyer must have made a fixed commitment to purchase the goods.
- The buyer must request that the transaction be on a bill-and-hold basis, and must have a substantial business purpose for this request.
- There must be a fixed schedule for delivery of the goods.
- The seller must not have retained any specific performance obligations such that the earning process is not complete.
- The ordered goods must be segregated from the seller's inventory.
- The goods must be complete and ready for shipment.

### **Characteristics of Sunbeam's Bill and Hold Sales**

The SEC found that Sunbeam's bill and hold sales were not requested by Sunbeam's customers and served no business purpose other than to accelerate revenue recognition by Sunbeam. Sunbeam's bill and hold sales were typically accompanied by financial incentives being offered to customers, such as discounted pricing, to encourage the "sale" to occur long before the customer actually needed the goods. Sunbeam would then hold the product until delivery was requested by the customer. Sunbeam also paid the costs of storage, shipment, and insurance related to the products. In addition, Sunbeam's customers had the right to return the unsold product.<sup>457</sup>

### **Sales to Distributors**

In December 1997, Sunbeam devised a "distributor program" that would help improve the company's sales in 1997. Sunbeam accelerated recognition of sales revenue for merchandise it placed with distributors in advance of actual retail demand. Sunbeam used favorable payment terms, discounts, guaranteed mark-ups, and, consistently, the right to return unsold product as incentives for distributors to participate in the program.

The sales under the distributor program represented a new distribution channel for the company. Therefore, Sunbeam was unable to set an appropriate level of reserves for returns.<sup>458</sup>

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<sup>456</sup> Staff Accounting Bulletin No. 101.

<sup>457</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>458</sup> SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, pp. 30–31.



## Restatement of Revenues and Other Significant Developments

In 1998, Sunbeam restated its revenues for 1997 from \$1,168,182 to \$1,073,090. In an amended filing of their 10K to the SEC, management wrote: “Upon examination, it was determined certain revenue was improperly recognized (principally ‘bill and hold’ and guaranteed sales transactions)...”<sup>459</sup> The company had reversed all “bill and hold” sales, which amounted to \$29 million in 1997, and about \$36 million in guaranteed or consignment sales, whose liberal return policies made the recognition of their revenue improper.<sup>460</sup>

Following several quarters of disappointing sales and earnings results, Sunbeam’s CEO Roger Schipke tendered his resignation in April 1996. The company named as Schipke’s successor Albert J. Dunlap, chief of Scott Paper Co. and a turnaround specialist who was nicknamed “Chainsaw Al” because of the cost-cutting measures he typically employed. Despite Dunlap’s efforts to achieve a successful turnaround, Sunbeam disappointed investors with lower-than-expected results in the fourth quarter of 1997 and the first quarter of 1998. CEO and Chairman Dunlap was fired in June 1998.

It was later uncovered that Sunbeam’s results in 1996, 1997, and 1998 were fraudulent in several aspects. In October 1998, Sunbeam announced that the audit committee of its Board of Directors had determined that the company would need to restate its prior financial statements, as follows: to reduce the 1996 net loss by \$20 million (9 percent of reported losses); to reduce 1997 net income by \$71 million (65 percent of reported earnings); and to increase 1998 earnings by \$10 million (21 percent of reported losses).<sup>461</sup>

Sunbeam’s auditor, Arthur Andersen, came under fire for having issued an unqualified opinion on the company’s financial statements for 1996 and 1997. In January 1999, a class action lawsuit alleging violation of the federal securities laws was filed in the U.S. District Court for the Southern District of Florida against Sunbeam,

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<sup>459</sup> Amended 1997 10K filing to SEC.

<sup>460</sup> Martha Brannigan, “Sunbeam Slashes Its 1997 Earnings in Restatement,” *Wall Street Journal*, October 21, 1998, p. 1.

<sup>461</sup> GAO-03-138, Appendix XVII “Sunbeam Corporation,” p. 201.

Arthur Andersen, and Sunbeam executives. The suit reached a settlement in August 2002. As part of the settlement, Andersen agreed to pay \$110 million.<sup>462</sup>

Phillip Harlow, the engagement Partner-in-Charge of the Sunbeam audit from 1993 to the summer of 1998, also found himself under fire for his work on the audits. The SEC barred Harlow from serving as a public accountant for three years after it found that Harlow failed to exercise professional care in performing the audits of Sunbeam's financial statements.<sup>463</sup>

## **1996 and 1997 Audits**

Through the course of the 1996 audit, Phillip Harlow allegedly became aware of several accounting practices that failed to comply with GAAP. In particular, he allegedly knew about Sunbeam's improper restructuring costs, excessive litigation reserves, and an excessive "cooperative advertising" figure.

Harlow also allegedly discovered several items that were not compliant with GAAP during the course of the 1997 audit. These items related to revenue, the restructuring reserves, and inventory, in particular. In several cases, Harlow made proposed adjustments that management refused to make. In response to management's refusal, Harlow acquiesced, however. By the end of 1997, it appears that Harlow knew that approximately 16 percent of Sunbeam's reported 1997 income came from items that he found to be noncompliant with GAAP.<sup>464</sup> In fact, at least \$62 million of Sunbeam's reported \$189 million of income before tax failed to comply with GAAP.<sup>465</sup>

## **Improper Restructuring Costs**

During the 1996 audit, Harlow allegedly identified \$18.7 million in items within Sunbeam's restructuring reserve that were improperly classified as restructuring costs because they benefited Sunbeam's future operations. Harlow proposed that the company reverse the improper accounting entries, but management rejected his proposed

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<sup>462</sup> Nicole Harris, "Andersen to Pay \$110 Million to Settle Sunbeam Accounting-Fraud Lawsuit," *Wall Street Journal*, May 2, 2001, B11.

<sup>463</sup> Cassell Bryan-Low, "Deals & Deal Makers," *Wall Street Journal*, January 28, 2003, C5.

<sup>464</sup> "Complaint for Civil Injunction and Civil Penalties," SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, 7–8.

<sup>465</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

adjustments for these entries. Harlow relented after deciding that the items were immaterial for the 1996 financials.<sup>466</sup>

### **Excessive Litigation Reserves**

Sunbeam also failed to comply with GAAP on a \$12 million reserve that was recorded for a lawsuit that alleged Sunbeam's potential obligation to cover a portion of the cleanup costs for a hazardous waste site. Management did not take appropriate steps to determine whether the amount reflected a probable and reasonable estimate of the loss. Had they done so, the reserve would not have passed either of the criteria. Harlow relied on statements from Sunbeam's General Counsel and did not take additional steps to determine that the litigation reserve level was compliant with GAAP.<sup>467</sup>

### **Excessive "Cooperative Advertising" Reserve**

Sunbeam also recognized an excessive figure for a "cooperative advertising" reserve established to fund a portion of its retailers' costs of running local promotions. At an amount of \$21.8 million, the reserve was approximately 25 percent higher than the prior year's accrual amount, without a proportional increase in sales. Harlow accepted management's representations that the accrual was an appropriate figure and did not ask for additional documentation to test the amount.<sup>468</sup>

### **Bill and Hold Sales**

The SEC found that Harlow "knew or recklessly disregarded facts indicating that the fourth-quarter bill and hold transactions did not satisfy required revenue recognition criteria."<sup>469</sup> Among other things, Sunbeam's revenues earned through bill and hold sales should not have been recognized because these sales were not requested by Sunbeam's customers and served no business purpose other than to accelerate revenue recognition by Sunbeam.

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<sup>466</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>467</sup> "Complaint for Civil Injunction and Civil Penalties," SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, pp. 7–8.

<sup>468</sup> *Ibid.*, 7–8.

<sup>469</sup> "Complaint for Civil Injunction and Civil Penalties," SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, 32–33.

Sunbeam offered their customers in the sales the right to return the unsold product. Further, several of Sunbeam's bill and hold sales were also characterized by Sunbeam offering its customers financial incentives, such as discounted pricing, to write purchase orders before they actually needed the goods.<sup>470</sup>

### **Sale of Inventory**

Sunbeam's fourth-quarter revenue included \$11 million from a sale of its spare parts inventory to EPI Printers, which, prior to this transaction, had satisfied spare parts and warranty requests for Sunbeam's customers on an as-needed basis. As part of the transaction, Sunbeam agreed to pay certain fees and guaranteed a 5 percent profit for EPI Printers on the resale of the inventory. The contract with EPI Printers also stipulated that it would terminate in January 1998 if the parties did not agree on the value of the inventory underlying the contract.

Harlow allegedly knew that revenue recognition on this transaction did not comply with GAAP because of the profit guarantee and the indeterminate value of the contract. Thus, he proposed an adjustment to reverse the accounting entries that reflected the revenue and income recognition for this transaction. Yet, Harlow acquiesced to management's refusal to reverse the sale.<sup>471</sup>

### **Improper Use of Reserves**

In the fourth quarter of 1997, Sunbeam improperly used excessive restructuring reserves to reduce current expenses. In fact, this use of reserves increased fourth-quarter income by almost 8 percent. Harlow proposed an adjustment to reverse this improper reduction. However, when management refused to make the adjustment, Harlow complied.<sup>472</sup>

### **Times of Trouble**

After the first quarter of 1997, Dunlap heralded the success of the company's turnaround efforts:

The impressive growth in both revenues and earnings is proof that the revitalization of Sunbeam is working.

In fact, the sales growth in the first quarter is the highest level achieved without acquisitions since Sunbeam

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<sup>470</sup> SEC Accounting and Auditing Enforcement Release No. 1393, May 15, 2001.

<sup>471</sup> "Complaint for Civil Injunction and Civil Penalties," SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, 33–34.

<sup>472</sup> "Ibid., 35–37.

became public in 1992.... The substantially higher earnings in the quarter from ongoing operations were due to increased sales coupled with the successful implementation of our restructuring efforts.<sup>473</sup>

Yet, by the fourth quarter of 1997, Sunbeam's results had fallen below expectations. Its first quarter results in 1998 earned a worse-than-expected loss of \$44.6 million.<sup>474</sup> CEO and Chairman Dunlap was fired in June 1998. In October 1998, Sunbeam announced that the audit committee of its Board of Directors had determined that the company would need to restate its prior financial statements, as follows: to reduce the 1996 net loss by \$20 million (9 percent of reported losses); to reduce 1997 net income by \$71 million (65 percent of reported earnings); and to increase 1998 earnings by \$10 million (21 percent of reported losses).<sup>475</sup>

Sunbeam filed for Chapter 11 bankruptcy protection in February 2001. In May 2001, the SEC brought charges of fraud against several former Sunbeam officials. At the end of 2002, the company emerged from Chapter 11 and changed its name to American Household. In early 2005, it was acquired by Jarden to be part of its consumer solutions division.

## **Comprehensive List of Case Questions**

1. Please consider the alleged accounting improprieties related to increased expenses from the 1996 audit. If you were auditing Sunbeam, what type of evidence would you like to review to determine whether Sunbeam had recorded the litigation reserve amount and the cooperative advertising amount in accordance with GAAP?
2. For the excessive litigation reserves and excessive "cooperative advertising" amount, please identify the journal entry that is likely to have been proposed by Andersen to correct each of these accounting improprieties. Why would Sunbeam be interested in recording journal entries that essentially reduced their income before tax in 1996?
3. As discussed in the case, during both the 1996 and the 1997 audit, Phillip Harlow allegedly discovered a number of different accounting entries made by Sunbeam that were not compliant with GAAP. Please speculate about

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<sup>473</sup> SEC v. Albert J. Dunlap, Russell A. Kersh, Robert J. Gluck, Donald R. Uzzi, Lee B. Griffith, and Phillip E. Harlow, p. 20.

<sup>474</sup> Robert Frank and Joann S. Lublin. "Dunlap's Ax Falls—6,000 Times—at Sunbeam." *Wall Street Journal*, November 13, 1996, B1.

<sup>475</sup> GAO-03-138, Appendix XVII "Sunbeam Corporation," p. 201.

how Mr. Harlow may have explained his decision not to require Sunbeam to correct these alleged misstatements in the audit working papers.

4. Consult Section 204 of SOX and Paragraphs 55–59 of PCAOB Auditing Standard No. 2. In the post-Sarbanes audit environment, which of the issues that arose in 1996 and 1997 would have to be reported to the audit committee at Sunbeam? Do you believe that communication to the audit committee would have made a difference in Mr. Harlow’s decision not to record the adjusting journal entries? Why or why not?
5. Based on your understanding of fraud risk assessment, what are the three conditions that are likely to be present when a fraud occurs? Based on your understanding of the Sunbeam audit, which of these three conditions appears to be most prevalent, and why?
6. Consult Paragraph #39 of PCAOB Auditing Standard No. 2. Based on your understanding of inherent risk assessment and case information, please identify three specific factors about Sunbeam that might cause you to elevate inherent risk.
7. Please consult Q39 and Q43 of the PCAOB Staff Questions & Answers (May 16, 2005). Comment about how your understanding of the inherent risks identified at Sunbeam (in Question #2) would influence the nature, timing, and extent of your audit work at Sunbeam.
8. Consult Paragraphs #71–72 of the Internal Control Standard. First, explain what is meant by “classes of transactions.” Next, based on the case information, list the different classes of transactions for the revenue account. Finally, do you believe that the different classes of transactions have differing levels of inherent risk? Why or why not?
9. Paragraph #25 of PCAOB Auditing Standard No. 2 requires management to design and implement controls to prevent, deter, and detect fraud. In addition, the standard requires the auditor to evaluate such controls (Paragraph #24). For one of Sunbeam’s classes of revenue transactions (choose one), please brainstorm about how a revenue recognition fraud might occur. Next, can you think of an internal control procedure that would prevent, detect, or deter such a fraudulent scheme?
10. Please explain what is meant by a restructuring reserve. As an auditor, what type of evidence would you want to examine to determine whether a company was inappropriately accounting for its restructuring reserve?
11. Refer to Paragraph #72 of PCAOB Auditing Standard No. 2. As an auditor, would you consider the different components of the restructuring reserve as having a “differing level” of inherent risk? Why or why not?

12. Please refer to Paragraphs #68–70 of PCAOB Auditing Standard No. 2. Identify one relevant financial statement assertion related to the restructuring reserve account. Why is it relevant?
13. This case describes a situation where a company overstated its recorded expenses in 1996 (as compared to understating recorded expenses). Why would a company choose to overstate its expenses and understate its net income?
14. Please consider Paragraphs #61–65 of PCAOB Auditing Standard No. 2. Do you believe that revenue derived from bill and hold sales, and revenue derived from sales to customers receiving special discounts should be evaluated differently when considering the design and operating effectiveness of the internal control system? Why or why not?
15. As an auditor, what type of evidence would you want to examine to determine whether Sunbeam was inappropriately recording revenue from special discount sales?
16. Please consider Paragraph #96 of PCAOB Auditing Standard No. 2. Do you believe that the control activity described would be helpful to detect the fraudulent sales recorded by Sunbeam to customers receiving special discounts? Why?
17. Consider Paragraphs #55–59 of PCAOB Auditing Standard No. 2. Identify one action that the Audit Committee of Sunbeam could have taken to help insure that a revenue recognition fraud would not have occurred.