

Refer to the excerpts of a 1998 filing by Sunbeam Corporation to answer the following questions. From October 1997 to March 1998, Sunbeam's stock price ranged between \$40 and \$50 per share. After the firm announced that it was going to miss earnings estimates and the market learned of an SEC accounting investigation, the stock price had fallen to below \$10 per share by the end of July.

Required:

1. What income statement and balance sheet accounts did Sunbeam manipulate during 1996 and 1997? Be as specific as possible.
2. Explain Sunbeam management's incentives for distorting financial statements in 1997.
3. Explain the repercussions of the misstated financial statements and deteriorating financial condition of Sunbeam.

PRESS RELEASES RELATING TO THE COMPANY'S FIRST QUARTER 1998 RESULTS

On March 19, 1998, the Company issued a press release announcing the possibility that its net sales for the first quarter of 1998 might be lower than the range of Wall Street analysts' estimates of \$285 million to \$295 million, but were expected to exceed the \$253.4 million in net sales achieved by the Company for the first quarter of 1997. On April 3, 1998, the Company issued a press release announcing that the Company then expected its net sales for the first quarter of 1998 would be approximately 5% lower than those achieved in the first quarter of 1997 and that the Company would report a loss for the quarter. On May 11, 1998, the Company announced results for the first quarter of 1998, including revenues of \$244.3 million, a net loss from continuing operations of \$7.8 million and a net loss of 52 cents per share, and stated that it expected earnings per share in the range of \$1.00 for 1998 and \$2.00 for 1999. On June 15, 1998, the Company announced that such forecasts should not be relied upon. Following each of these press releases, the market price of the Company's stock fell substantially. The Company subsequently issued a press release restating operating results for the first quarter of 1998. See "Restatement of Financial Results" and Item 3--Legal Proceedings, below.

Sunbeam Corporation And Subsidiaries

Notes To Consolidated Financial Statements

1. OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Sunbeam Corporation ("Sunbeam" or the "Company") is a leading manufacturer and marketer of branded consumer products. The Sunbeam® and Oster® brands have been household names for generations, and the Company is a market share leader in many of its product categories.

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13. RESTATEMENT

Subsequent to the issuance of the Company's Consolidated Financial Statements for the fiscal years ended December 28, 1997 and December 29, 1996, it was determined that the reported results generally inflated 1997 results at the expense of 1996 results. Upon examination, it was determined certain revenue was improperly recognized (principally "bill and hold" and guaranteed sales transactions), certain costs and allowances were not accrued or were improperly recorded (principally allowances for returns, cooperative advertising, and customer charge-backs as well as deductions and reserves for product liability and warranty expense) and certain costs were inappropriately included in, and subsequently charged to, restructuring, asset impairment and other costs within the Consolidated Statement of Operations. As a result, the accompanying Consolidated Financial Statements as of December 28, 1997 and December 29, 1996, and for the years then ended, present the restated results.

A summary of the effects of the restatement follows (in thousands, except per share data):

Consolidated Statements Of Operations

	FISCAL YEARS ENDED		DECEMBER 29,	
	DECEMBER 28,		1996	
	1997			
	AS PREVIOUSLY REPORTED	AS RESTATED	AS PREVIOUSLY REPORTED	AS RESTATED
Net sales	\$ 1,168,182	\$ 1,073,090	\$ 984,236	\$ 984,236
Cost of goods sold	837,683	830,956	900,573	896,938
Selling, general and administrative expense	131,056	152,653	214,029	221,655
Restructuring and asset impairment (benefit) charges	--	(14,582)	154,869	110,122
Operating earnings (loss)	199,443	104,063	(285,235)	(244,479)
Interest expense	11,381	11,381	13,588	13,588
Other (income) expense, net	(1,218)	12	3,738	3,738
Earnings (loss) from continuing operations before income taxes	189,280	92,670	(302,561)	(261,805)
Income taxes (benefit)	66,152	40,352	(105,890)	(91,625)
Earnings (loss) from continuing operations	123,128	52,318	(196,671)	(170,180)
Loss from discontinued operations, net	(13,713)	(14,017)	(31,591)	(38,301)
Net earnings (loss)	<u>\$ 109,415</u>	<u>\$ 38,301</u>	<u>\$ (228,262)</u>	<u>\$ (208,481)</u>
Earnings (loss) per share of common stock from continuing operations:				
Basic	\$ 1.45	\$ 0.62	\$ (2.37)	\$ (2.05)
Diluted	\$ 1.41	\$ 0.60	\$ (2.37)	\$ (2.05)
Loss from discontinued operations:				
Basic.....	\$ (0.16)	\$ (0.17)	\$ (0.38)	\$ (0.46)
Diluted	\$ (0.16)	\$ (0.16)	\$ (0.38)	\$ (0.46)
Net earnings (loss) per share of common stock:				
Basic	\$ 1.29	\$ 0.45	\$ (2.75)	\$ (2.51)
Diluted	\$ 1.25	\$ 0.44	\$ (2.75)	\$ (2.51)

Consolidated Balance Sheets

	AS OF DECEMBER 28, 1997		AS OF DECEMBER 29, 1996	
	AS PREVIOUSLY REPORTED	AS RESTATED	AS PREVIOUSLY REPORTED	AS RESTATED
ASSETS				
Cash and cash equivalents	\$ 52,378	\$ 52,298	\$ 11,526	\$ 11,526
Receivables, net	295,550	228,460	213,438	209,754
Inventories	256,180	304,900	162,252	164,345
Net assets of discontinued operations and other assets held for sale	--	--	102,847	92,524
Deferred income taxes	36,706	--	93,689	85,067
Prepaid expenses and other current assets	<u>17,191</u>	<u>16,584</u>	<u>40,411</u>	<u>38,381</u>
Total current assets	658,005	602,242	624,163	601,597
Property, plant and equipment, net	240,897	249,524	220,088	229,393
Trademarks, trade names, goodwill and other net	<u>221,382</u>	<u>207,162</u>	<u>228,458</u>	<u>228,458</u>
Total assets	<u>\$ 1,120,284</u>	<u>\$ 1,058,928</u>	<u>\$ 1,072,709</u>	<u>\$ 1,059,448</u>
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current portion of long-term debt	\$ 668	\$ 668	\$ 921	\$ 921
Accounts payable	105,580	108,374	107,319	104,113
Restructuring accrual	10,938	5,186	63,834	51,725
Other current liabilities	<u>80,913</u>	<u>118,899</u>	<u>99,509</u>	<u>84,986</u>
Total current liabilities	198,099	233,127	271,583	241,745
Long-term debt	194,580	194,580	201,115	201,115
Other long-term liabilities	141,109	154,300	152,451	149,247
Deferred income taxes	54,559	4,842	52,308	52,308
Preferred stock	--	--	--	--
Common stock	900	900	884	884
Paid-in capital	483,384	479,200	447,948	447,948
Retained earnings	141,134	89,801	35,118	54,899
Other	(30,436)	(34,777)	(25,310)	(25,310)
Treasury stock	<u>(63,045)</u>	<u>(63,045)</u>	<u>(63,388)</u>	<u>(63,388)</u>
Total shareholders' equity	<u>531,937</u>	<u>472,079</u>	<u>395,252</u>	<u>415,033</u>
Total liabilities and shareholders' equity	<u>\$ 1,120,284</u>	<u>\$ 1,058,928</u>	<u>\$ 1,072,709</u>	<u>\$ 1,059,448</u>

15. SUBSEQUENT EVENTS (UNAUDITED)

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On June 15, 1998, the Company's Board of Directors announced the removal of the then Chairman and Chief Executive Officer and subsequently announced the removal or resignation of other senior officers, including the Company's Chief Financial Officer. In connection with the removal or resignation of the senior officers and the termination of their restricted stock grants the unamortized portion of the deferred compensation expense attributable to the restricted stock grants, will be reversed and compensation expense of approximately \$0.9 million recognized in the first quarter for unvested restricted stock grants will be reversed into income in the second and third quarters of 1998. Other costs related to the resignations and terminations will be recognized, as appropriate, in 1998. The Company and certain of its former officers are in disagreement as to the Company's obligations to these individuals under prior employment agreements and arising from their terminations. The Board of Directors has installed a new Chief Executive Officer and senior management team.

ACQUISITIONS

On March 30, 1998, the Company, through a wholly-owned subsidiary, acquired approximately 81% of the total number of then outstanding shares of common stock of The Coleman Company, Inc. ("Coleman"), from a subsidiary of MacAndrews & Forbes Holdings, Inc. ("M&F"), in exchange for 14,099,749 shares of the Company's common stock and approximately \$160 million in cash as well as the assumption of \$1,016 million in debt. Coleman is a leading manufacturer and marketer of consumer products for the worldwide outdoor recreation market. Its products have been sold domestically under the Coleman® brand name since the 1920's.

On August 12, 1998, the Company announced that, following investigation and negotiation conducted by a Special Committee of the Board consisting of four outside directors not affiliated with M&F, the Company had entered into a settlement agreement with a subsidiary of M&F pursuant to which the Company was released from certain threatened claims of M&F and its affiliates arising from the Coleman acquisition and M&F agreed to provide certain management personnel and assistance to the Company in exchange for the issuance to the M&F subsidiary of five-year warrants to purchase up to 23 million shares of the Company's common stock at an exercise price of \$7.00 per share, subject to anti-dilution provisions. The financial statement impact of the settlement, which will be material in amount, will be recorded in the third quarter of 1998.

The Company expects to acquire the remaining equity interest in Coleman pursuant to a merger transaction in which the existing Coleman minority shareholders will receive .5677 shares of the Company's common stock and \$6.44 in cash for each share of Coleman common stock outstanding. In addition, unexercised options under Coleman's stock option plans will be cashed out at a price per share equal to the difference between \$27.50 and the exercise price of such options. The Company expects to issue approximately 6.7 million shares of common stock and expend approximately \$87 million in cash to complete the Coleman acquisition. (See Litigation and Further Actions below.)

On April 6, 1998, the Company completed the cash acquisitions of First Alert, Inc. ("First Alert"), a leading manufacturer of smoke and carbon monoxide detectors, and Signature Brands USA, Inc. ("Signature Brands"), a leading manufacturer of a comprehensive line of consumer and professional products. The First Alert and the Signature Brands acquisitions were valued at approximately \$178 million and \$253 million, respectively, including the assumption of debt.

The above acquisitions will be accounted for by the purchase method of accounting and the results of operations of the acquired entities will be included in the Company's Consolidated Statement of Operations from the respective acquisition dates.

DEBENTURES AND NEW CREDIT FACILITY

In order to finance the above acquisitions, and refinance substantially all of the indebtedness of the Company, Coleman, First Alert, and Signature Brands, the Company consummated: (i) an offering (the "Offering") of Zero Coupon Convertible Senior Subordinated Debentures due 2018 (the "Debentures") at a yield to maturity of 5% (approximately \$2,014 million principal amount at maturity) in March 1998, which resulted in approximately \$730 million of net proceeds and, (ii) entered into a revolving and term credit facility ("New Credit Facility") in April 1998.

The Debentures are exchangeable for shares of the Company's common stock at an initial conversion rate of 6.575 shares for each \$1,000 principal amount at maturity of the Debentures, subject to adjustment upon occurrence of certain events. The Company was required to file a registration statement with the Securities and Exchange Commission to register the Debentures by June 23, 1998, which registration statement has not been filed. From June 23, 1998 until the day on which the registration statement is filed and declared effective, the Company is required to pay to the Debenture holders cash liquidated damages accruing, for each day during such period, at a rate per annum equal to 0.25% during the first 90 days and 0.50% thereafter multiplied by the total of the issue price of the Debentures plus the original issue discount thereon on such day. The Company made its first payment of approximately \$525,000 to the Debenture holders on September 25, 1998.

The New Credit Facility provided for an aggregate borrowings of up to \$1.7 billion pursuant to: (i) a revolving credit facility in an aggregate principal amount of up to \$400 million, maturing March 31, 2005; (ii) an \$800 million term loan maturing on March 31, 2005, and (iii) a \$500 million term loan maturing September 30, 2006. Interest accrues at a rate selected at the Company's option of: (i) the London Interbank Offered Rate ("LIBOR") plus an agreed upon interest margin which varies depending upon the Company's leverage ratio, as defined, and other items or, (ii) the base rate of the administrative agent (generally the higher of the prime commercial lending rate of the administrative agent or the Federal Funds Rate plus 1/2 of 1%), plus an agreed upon interest margin which varies depending upon the Company's leverage ratio, as defined, and other items. At June 30, 1998, the Company was not in compliance with the financial covenants and ratios required. The Company and its lenders entered into an agreement dated June 30, 1998, which provided that compliance with the covenants would be waived through December 31, 1998. Borrowings under the New Credit Facility are secured by certain of the Company's assets, including its stock interest in Coleman and certain other subsidiaries and certain of the Company's tangible and intangible personal property. The New Credit Facility contains certain covenants, including limitations on the ability of the Company and its subsidiaries to engage in certain transactions and the requirement to maintain certain financial covenants and ratios. Pursuant to an amendment dated October 19, 1998, the Company is not required to comply with the original financial covenants and ratios under the New Credit Facility until April 10, 1999, but will be required to comply with an earnings before interest, taxes, depreciation and amortization covenant, the amounts of which are to be determined, beginning February 1999. Concurrent with each of these amendments, interest margin was increased. The margin continues to increase monthly through March 1999 to a maximum of 400 basis points over LIBOR. At September 30, 1998, following the scheduled repayment of a portion of the term loan, the New Credit Facility was reduced to \$1,698 million in total, of which approximately \$1,453 million was outstanding and approximately \$245 million was available. In addition, the Company's cash balance at September 30, 1998 was approximately \$43 million.

The Company is working closely with its bank lenders and hopes to reach agreement with the bank lenders on a further amendment to the New Credit Facility containing revised financial covenants, which the bank lenders and the Company find mutually acceptable. There can be no assurance that such an amendment, or a further waiver of the existing financial covenants, will be entered into with the bank lenders by April 10, 1999. The failure to obtain such an amendment or further waiver would result in a violation of the existing covenants, which would permit the bank lenders to accelerate the maturity of all outstanding borrowings under the New Credit Facility.

In March, 1998, the Company prepaid a \$75.0 million 7.85% industrial revenue bond related to its Hattiesburg facility originally due in 2009. In connection with the early extinguishment of this debt, the Company will record a charge of \$8.6 million in the first quarter of 1998. Also, as a result of repayment of certain indebtedness assumed in the Coleman acquisition, the Company will recognize an extraordinary charge of approximately \$104 million in the second quarter of 1998.

At September 30, 1998, the standby letters of credit aggregated \$56 million, including \$5 million related to an acquired company, and were predominately for insurance, pension, environmental and workers' compensation issues.

SEC INVESTIGATION

By letter dated June 17, 1998, the staff of the Division of Enforcement of the SEC advised the Company that it was conducting an informal inquiry into the Company's accounting policies and procedures and requested that the Company produce certain documents. On July 2, 1998, the SEC issued a Formal Order of Private Investigation, designating officers to take testimony and pursuant to which a subpoena duces tecum was served on the Company requiring the production of certain documents. The Company has provided numerous documents to the SEC staff and continues to cooperate fully with the SEC staff. The Company cannot predict the term of such investigation or its potential outcome.

LITIGATION

On April 23, 1998, two class action lawsuits were filed on behalf of purchasers of the Company's common stock in the U. S. District Court for the Southern District of Florida against the Company and certain of its present and former officers and directors alleging violations of the federal securities laws as discussed below (the "Consolidated Federal Actions"). Since that date, at least fifteen similar class actions have been filed in the same Court. One of the lawsuits also names as defendant Arthur Andersen LLP, the Company's independent accountants.

The complaints in the Consolidated Federal Actions allege to varying degrees that the defendants (i) failed to disclose that the Company pre-sold approximately \$50 million of products pursuant to its "early buy" marketing program in an effort to boost its 1997 sales and net income figures and (ii) made material misrepresentations regarding the Company's business operations, future prospects and anticipated earnings per share, in an effort to artificially inflate the price of the Company stock long enough for the Company to complete a \$2 billion debt financing (supported with stock incentives) necessary to complete the acquisitions of Coleman, Signature Brands and First Alert, and for the individual defendants to enter into lucrative long-term employment agreements with the Company. Each complaint alleges two counts of securities fraud; one count against all defendants and one count against the individual defendants.

On June 16, 1998, the Court entered an Order consolidating all such filed and all such subsequently filed class actions and providing time periods for the filing of a Consolidated Amended Complaint and defendants' response thereto. On June 22, 1998, two groups of plaintiffs made motions to be appointed lead plaintiffs and to have their selection of counsel approved as lead counsel. On July 20, 1998, the Court entered an Order appointing lead plaintiffs and lead counsel (the "Smith Plaintiffs' Group"). This Order also stated that it "shall apply to all subsequently filed actions which are consolidated herewith". On August 28, 1998, plaintiffs in one of the subsequently filed actions filed an objection to having their action consolidated pursuant to the June 16, 1998 Order, arguing that the class period in their action differs from the class periods in the originally filed consolidated actions. On September 29, 1998, the Smith Plaintiffs' Group filed its memorandum in opposition to this objection.

On April 7, 1998, a purported derivative action was filed in the Circuit Court for the Fifteenth Judicial Circuit in and for Palm Beach County, Florida against the Company and certain of its present and former officers and directors. The action alleged that the individual defendants breached their fiduciary duties and wasted corporate assets when the Company granted stock options to three of its officers and directors on or about February 2, 1998 at an exercise price of \$36.85. On June 25, 1998, all defendants filed a motion to dismiss the complaint for failure to make a presuit demand on the board of directors of the Company. (See Further Actions, below.)

On June 25, 1998, four purported class actions were filed in the Court of Chancery of the State of Delaware in New Castle County by minority shareholders of Coleman against Coleman, certain of the Company's present and former officers and directors and, as a nominal party, the Company. An additional class action was filed on August 10, 1998, against the same parties. All of the plaintiffs are represented by the same Delaware counsel and have agreed to consolidate the class actions. These actions allege, in essence, that the existing exchange ratio for the proposed merger between the Company and Coleman is no longer fair to Coleman shareholders as a result of the recent decline in the market value of the Company stock. (See Further Actions, below.)

During the months of August and October 1998, purported class and derivative actions were filed in the Court of Chancery of the State of Delaware in New Castle County and in the U. S. District Court for the Southern District of Florida by shareholders of the Company against the Company, M&F and certain of the Company's present and former directors. These complaints allege that the defendants breached their fiduciary duties when the Company entered into a settlement agreement with M&F whereby M&F released the Company from any claims it may have had arising out of the Company's acquisition of its interest in Coleman and agreed to provide management support to the Company (the "Settlement Agreement"). Pursuant to the Settlement Agreement, a subsidiary of M&F was granted five-year warrants to purchase up to an additional 23 million shares of the Company's common stock at an exercise price of \$7.00 per share. These complaints also allege that the rights of the public shareholders have been compromised, as the settlement would normally require shareholder approval under the rules and regulations of the New York Stock Exchange ("NYSE"). The Audit Committee of the Company's board determined that obtaining such shareholder approval would have seriously jeopardized the financial viability of the Company, which is an allowable exception to the NYSE shareholder approval requirements.

On September 16, 1998, an action was filed in the 56th Judicial District Court of Galveston County, Texas alleging various claims in violation of the Texas Securities Act and Texas Business and Commercial Code as well as common law fraud as a result of the Company's alleged misstatements and omissions regarding the Company's financial condition and prospects during a period beginning May 1, 1998 and ending June 16, 1998, in which the plaintiffs engaged in transactions in the Company's stock. The Company is the only named defendant in this action. The complaint requests recovery of compensatory damages, punitive damages and expenses in an unspecified amount. This action has been removed to the U.S. District Court for the Southern District of Texas and the Company has filed a motion for consolidation of this case with the Consolidated Federal Actions. Plaintiffs have moved to remand the case to Texas state court.

The Company intends to vigorously defend each of the foregoing lawsuits, as well as the Debentures purchasers' lawsuit reflected under Further Actions, below, but cannot predict the outcome and is not currently able to evaluate the likelihood of the Company's success in each case or the range of potential loss. However, if the foregoing actions were determined adversely to the Company, such judgments would likely have a material adverse effect on the Company's financial position, results of operations and cash flows.

On July 2, 1998, the American Insurance Company ("American") filed suit against the Company in the U.S. District Court for the Southern District of New York requesting a declaratory judgment of the court that the directors' and officers' liability insurance policy for excess coverage issued by American was invalid and/or had been properly cancelled by American. The Company has moved to transfer such action to the federal district court in which the Consolidated Federal Actions are currently pending; American is opposing such motion. (See Further Actions, below). The Company intends to pursue recovery from all of its insurers if damages are awarded against the Company or its indemnified officers and/or directors under any of the foregoing actions. The Company's failure to obtain such insurance recoveries following an adverse judgment in any of the foregoing shareholder lawsuits or the Debentures purchasers' lawsuit referred to under Further Actions, below, could have a material adverse impact on the Company's financial position, results of operations and cash flow.

The Company and its subsidiaries are also involved in various lawsuits arising from time to time, which the Company considers to be ordinary routine litigation incidental to its business. In the opinion of the Company, the resolution of these routine

matters, and of certain matters relating to prior operations of the Predecessor, individually or in the aggregate, will not have a material adverse effect upon the financial position or results of operations of the Company.

FURTHER ACTIONS

On October 22, 1998, the plaintiff in the case filed April 7, 1998, amended the complaint against all but one of the defendants named in the original complaint. The amended complaint no longer challenges the stock options, but instead alleges that the individual defendants breached their fiduciary duties by failing to have in place adequate accounting and sales controls, which failure caused the inaccurate reporting of financial information to the public, thereby causing an artificial inflation of the Company's financial statements and stock price.

On October 21, 1998, the Company announced that it had entered into a Memorandum of Understanding to settle, subject to court approval, certain class actions brought by shareholders of Coleman challenging the proposed Coleman Merger. Under the terms of the proposed settlement, the Company will issue to the Coleman public shareholders five-year warrants to purchase 4.98 million shares of the Company's common stock at \$7.00 per share. These warrants will generally have the same terms as the warrants previously issued to a subsidiary of M&F and will be issued when the Coleman Merger is consummated, which is now expected to be in the first quarter of 1999. There can be no assurance that the Court will approve the settlement as proposed.

On October 20, 1998, an action was filed by Federal Insurance Company in the U.S. District Court for the Middle District of Florida requesting the same relief as that requested by American in the previously filed action as to additional coverage levels under the Company's directors' and officers' liability insurance policy.

On October 30, 1998, a class action lawsuit was filed on behalf of certain purchasers of the Company's Debentures in the U.S. District Court of the Southern District of Florida against the Company and its prior Chief Executive Officer and Chief Financial Officer, alleging violations of the federal securities laws and common law fraud. The complaint alleges that the Company's offering memorandum used for the marketing of the Debentures contained false and misleading information regarding the Company's financial position and that the defendants engaged in a plan to inflate the Company's earnings for the purpose of defrauding the plaintiffs and others. The Company has not yet been served with this complaint.

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Solution:

1. In 1996, it overstated its restructuring charges on the income statement and its restructuring accrual on its balance sheet. This had the effect of understating 1996 net income and increasing 1997 income.

In 1997, it overstated its sales and understated its selling, general and administrative expense. These manipulations resulted in overstated accounts receivable, understated inventory, and understated other current liabilities. Much of the revenue overstatement related to the mishandling of "bill and hold" transactions.

2. Sunbeam was involved in acquiring firms, issuing new debt, and negotiating employment contracts. The description of litigation states that management made misrepresentations to inflate the stock price long enough to "complete a \$2 billion debt financing (supported with stock incentives) necessary to complete the acquisitions of Coleman, Signature Brands, and First Alert, and for the individual defendants to enter into lucrative long-term employment agreements...." It also appears from Note 15 that top management had restricted stock.

3. There are several:
 - a. SEC investigation
 - b. Firing of management
 - c. Lawsuits
 - i. Coleman owners
 - ii. Shareholders
 - iii. Bondholders
 - iv. Insurers
 - d. Renegotiation of merger price (had to include warrants)
 - e. Renegotiation of debt agreements
 - i. Violation of debt covenants
 - ii. Paying higher interest rate
 - iii. Stricter debt covenants