

U.S. Foodservice: A Case Study in Fraud and Forensic Accounting

Maria H. Sanchez
Christopher P. Agoglia *

LEARNING OBJECTIVES

After completing and discussing this case, students should be able to:

- Understand the basics of accounting for vendor rebates
- Understand the dangers of over relying on third party confirmations as an audit procedure
- Understand the responsibilities of the external auditor for detecting fraud
- Appreciate the importance of professional skepticism
- Understand the difference between a financial statement audit and a forensic audit
- Appreciate the importance of ethical behavior in the accounting profession

INTRODUCTION

U.S. Foodservice was acquired by the Dutch company Royal Ahold, NV (Ahold) in 2000. U.S. Foodservice was the second-largest distributor of food to restaurants, hotels, schools, hospitals, and Ahold's extensive chains of U.S. grocery stores. A material portion of U.S. Foodservice's balance sheet was promotional allowances receivable from vendors (vendor rebates). As part of their normal audit procedures for U.S. Foodservice, Ahold's independent auditors Deloitte and Touche sent confirmations for these receivables. Confirmations were mailed to vendors' salespeople and were returned without exceptions. For the first two years after the acquisition, the auditors issued unqualified opinions. During the 2002 audit, however, Ahold's independent auditors discovered problems and promptly withdrew their audit opinions for 2000 and 2001, and suspended their 2002 audit (Masters and McCartney, 2003). On February 24, 2003, Ahold announced that it would restate earnings downward for the fiscal years 2000 and 2001, and for the first three quarters of 2002 by a combined total of at least \$500 million and that a forensic accounting investigation would be launched, mostly because of irregularities at Ahold's subsidiary U.S. Foodservice.

The company's stock price lost nearly two-thirds of its value on the day of the announcement. Ahold's chief executive and chief financial officers resigned when the announcement was made, and subsequently other high-level managers at both the parent

* The authors are, respectively, at Rider University and the University of Massachusetts Amherst.

company and U.S. Foodservice also stepped down (Stecklow, Raghavan & Ball, 2003). On March 24, 2003, Ahold's audit committee ordered investigations at the parent company and at 17 Ahold operating and real estate companies to look for accounting errors, irregularities, and other issues as well as assess internal controls and management integrity (Ahold, 2003a). After a forensic audit, Ahold eventually reported that the overstatement of U.S. Foodservice's earnings was more than \$850 million (Ball, 2003). A large component of the overstatement resulted from improper recognition of promotional allowances. Several U.S. Foodservice employees and vendors either admitted to or were convicted of playing a role in the fraud. In this case, students will gain insights into the proper accounting for and disclosure of promotional allowances and also the risk of over-reliance on third party confirmation as an audit procedure. Students will also distinguish between a financial statement audit and a forensic audit.

SOME BACKGROUND

Accounting for cash consideration from vendor rebates, also known as "promotional allowances," was at the center of the U.S. Foodservice's earnings restatement. Rebates of this type are common in the grocery and foodservice industries and are frequently material in amount, sometimes exceeding 5% of sales. Vendors can offer rebates to customers in exchange for favorable display space in stores, or they may give volume rebates to provide an incentive to a retailer to increase sales of the vendor's products, with the rebate percentage increasing as the retailer's sales volume increases. However, these rebates are problematic in several respects. At the time of U.S. Foodservice's accounting irregularities, there was no standardized accounting treatment of these rebates. Companies have accounted for them differently, and there have been differing levels of disclosure regarding their amounts. The investigation at U.S. Foodservice revealed that determination of rebates receivable can be problematic.

Even before the investigation into U.S. Foodservice's accounting practices, supplier rebate issues have come under scrutiny and have even resulted in regulatory action against other retailers. The Securities and Exchange Commission (SEC), as an example, alleged that among the accounting irregularities that occurred at Rite Aid in the late 1990's was how the company accounted for its vendor rebates. In June 2002, the SEC's Accounting and Auditing Enforcement Release No. 1581 indicated that Rite Aid improperly recognized \$75 million in vendor rebates, which represented 37% of the company's pre-tax income in 1999 (SEC, 2002). Kroger Co. of

Cincinnati had to restate its earnings from 1998 to 2000 as a result of how one of its acquired companies had accounted for such rebates. Similar irregularities and allegations of impropriety regarding recognition of vendor rebates have led to earnings restatements and/or regulatory actions at other companies, including Just for Feet, Fleming Cos., and Great Atlantic & Pacific Tea Co. (Bryan-Low, 2003; Bryan-Low & Schroeder, 2003). More recently, the SEC filed a suit with Penn Traffic grocery stores in which the SEC alleged that Penn Traffic intentionally inflated income by prematurely recognizing income from promotional allowances (SEC, 2008).

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR VENDOR REBATES

Prior to 2002, there was no standardization regarding the accounting for or disclosure of these vendor rebates. Companies often “buried” the rebates in their financial statements, even though they were frequently material in amount, particularly for retailers such as U.S. Foodservice (Bryan-Low, 2003). In August 2002, the Financial Accounting Standards Board (FASB) released Emerging Issues Task Force (EITF) Issue No. 02-16, *Accounting by a Reseller for Cash Consideration Received from a Vendor*, which addressed the accounting for and disclosure of these rebates. In the EITF, the FASB outlined three possible views of these rebates. Depending upon the circumstances under which it is being offered, a vendor rebate may represent: 1) a reduction in the cost of sales to the reseller; 2) a reduction in some other expense, e.g., advertising; or 3) a type of revenue for the reseller. Generally, cash consideration from a vendor is presumed to be a reduction of the price of the vendor’s products or services and should, therefore, be a reduction in the cost of sales when recognized in the reseller’s income statement. That presumption can be overcome, however, under two different sets of circumstances: 1) if the cash consideration is intended to reimburse the reseller for costs incurred (e.g., advertising), then the consideration received by the reseller should be recorded as a reduction in that expense; or 2) if the cash consideration is primarily payment for the reseller’s expertise and efforts in a particular endeavor (e.g., market research), then the consideration should be recognized as revenue by the reseller (FASB, 2002).

Additionally, the Task Force concurred that if the cash consideration is primarily an incentive for the reseller to achieve certain sales levels, or to remain a customer of the vendor for a specified period of time, then the consideration should reduce the reseller’s cost of sales. This reduction in cost of sales should be systematic and rational, reflecting the underlying progress of

earning the incentive, assuming that the reseller's progress is probable and reasonably estimable. If the progress is not probable, or it cannot be reasonably estimated, the consideration should reduce the reseller's cost of sales as the relevant milestone is achieved (FASB, 2002).¹

As an example, assume that retailer ABC Company is entitled to a 10% rebate of the purchase price of merchandise purchased from vendor XYZ Company if ABC Company is able to sell \$1,000 of XYZ Company's products during the coming year. If it is probable that ABC will meet the \$1,000 target and the company can also reasonably estimate its progress towards achieving the milestone, ABC should recognize the 10% rebate in a systematic and rational manner. If, on the other hand, the probability of ABC achieving the \$1,000 sales level is uncertain or if ABC cannot reasonably estimate its progress in reaching the milestone, ABC should recognize the entire 10% rebate as a reduction in cost of sales only upon reaching the \$1,000 target. The Task Force's position was clear that *immediate* recognition of cash consideration as a reduction of cost of sales or as revenue was *not* acceptable. U.S. Foodservice appears to have been recognizing the vendor rebates as it *purchased* the product not when it was sold. Additionally, federal authorities alleged that U.S. Foodservice deliberately booked vendor rebates to which they were not entitled. Thus, not only is this an accounting issue with respect to the *timing* of recognition of the rebates, but it is also an issue of fraudulently recognizing rebates that did not exist.

WHAT HAPPENED AT U.S. FOODSERVICE

U.S. Foodservice was acquired by Ahold in 2000. Prior to this, U.S. Foodservice used KPMG as their auditor. After the acquisition, U.S. Foodservice was audited by Deloitte & Touche, Ahold's auditor. During their 2002 audit of Ahold's financial statements, as part of their confirmation process at U.S. Foodservice, Deloitte discovered that certain accrued vendor allowance receivable balances were overstated. Deloitte uncovered a series of accounting irregularities at U.S. Foodservice and other Ahold subsidiaries and also improper accounting for certain of Ahold's joint ventures (Parker, 2003). Deloitte immediately withdrew their audit opinions for 2000 and 2001 and suspended work on the 2002 audit.

There appeared to be a confluence of economic conditions, managerial "inventiveness," and failures of internal controls that led to the accounting irregularities at U.S. Foodservice.

¹ This EITF has been codified into FASB ASC 605-50.

Company sales for the year 2002 had been decreasing. In last quarter of 2002, upper management held a conference call with its divisional managers advising them that their annual bonuses were at risk if sales were not boosted. According to testimony provided by those inside the company, in that conference call, the company's chief operating officer described an "initiative" that would increase the likelihood of managers receiving their bonuses and help the company achieve its sales target for the year. Quite simply, the strategy was to order large amounts of inventory and immediately recognize the vendor rebates that accompanied them. The rebates were in many cases substantial and, according to some sources, ranged from 8.5% to 46% of the purchase price. Divisional managers stated that they were told by upper management that if they did not place orders for additional inventory, then it would be done for them. These managers reported that it was made clear that if they did not go along with the "initiative," not only were their bonuses in jeopardy, but perhaps their jobs were as well (Stecklow, Raghavan, & Ball, 2003).

Soon the warehouses at U.S. Foodservice were overflowing with inventory of food-related items and paper products. The amount of inventory the company purchased was so large that it had to rent additional space and refrigerator trucks to store it. As purchases increased, the vendor rebates to which U.S. Foodservice were entitled also increased. Supplier rebates increased from approximately \$125 million in 2000 to about \$700 million in 2003 (Bray, 2006). These rebates were recognized immediately as products were purchased in an attempt to boost earnings. The excess inventory was so immense, however, that even after the announcement of the earnings restatement, it was questionable whether the company would be able to sell it. In an effort to unload the massive amount of product in its warehouses, the company had to reduce its selling price below its original cost in some cases (Stecklow, Raghavan, & Ball, 2003).

During the audit of U.S. Foodservice, third party confirmations of rebates receivable had been provided by the vendors' salespeople, not their accounting departments. According to complaints filed by the SEC, employees at U.S. Foodservice urged their vendors to complete and return to the auditors false confirmation letters with dollar amounts intentionally overstated, sometimes by as much as millions of dollars. Some vendors were pressured, some were provided with secret "side letters" assuring the vendors that they did not owe the amounts listed on the confirmations (Securities and Exchange Commission, 2006b).

In a span of several months, the “initiative” proposed by the company’s COO unraveled. Rather than helping the company out of its economic doldrums, the scheme instead resulted in earnings restatements, plunging stock price, several high-level managers losing their jobs, regulatory investigation of the company’s accounting practices, and allegations that officials in both the U.S. and Dutch offices had criminal intent to deceive and defraud the investing public (Stecklow, Raghavan, & Ball, 2003). In July 2003, Dutch officials raided Ahold’s headquarters and began a criminal probe (Sterling, 2003). One year later, in July 2004, U.S. officials announced that two former U.S. Foodservice executives were being formally charged with conspiracy, securities fraud, and making false filings. Prosecutors also announced at the same time that two other U.S. Foodservice managers had admitted to their roles in the same alleged scheme of overstating earnings (McClam, 2004).

THE FORENSIC AUDIT

After the irregularities were uncovered by the external auditors, a criminal investigation was launched by the U.S. Department of Justice. In addition, Ahold appointed a team of forensic accountants from PricewaterhouseCoopers to work alongside the SEC. The forensic accountants had to sort through tens of thousands of documents (Datson, 2003). A U.S. federal grand jury issued subpoenas for Ahold documents for as far back as January 1, 1999 (Buckley and Chaffin, 2003).

The forensic audit revealed fraud at U.S. Foodservice totaling over \$850 million, with over \$100 relating to 2000, over \$200 million relating to 2001 and the rest relating to 2002. The fraud related to fictitious and/or overstated vendor allowance receivables and improper or premature recognition of vendor allowances and an understatement of cost of goods sold (Ahold, 2003a). Numerous U.S. Foodservice employees were involved in the fraud, and it was discovered that the fraud went back as far as 2000. U.S. Foodservice employees were found to have been using inflated recognition rates for vendor allowances and intentionally misapplying both Dutch and U.S. GAAP. Deloitte’s audit testing using third party confirmations failed to detect management’s misrepresentation of the reduction in cost of sales resulting from these manufacturer rebates (Bryan-Low, 2003).

The probe of U.S. Foodservice expanded to investigate several of the company’s suppliers, including Sara Lee and ConAgra Foods, to determine if they might have been

complicit in U.S. Foodservice's intent to misrepresent certain financial statement assertions. The investigation revealed that U.S. Foodservice employees asked salespeople at their vendors to sign false documentation for Deloitte and that some vendors cooperated with this fraudulent scheme. Three salespeople at Sara Lee admitted that they had signed off on, and forwarded to U.S. Foodservice's external auditors, erroneous documents that reflected inflated amounts owed to the company by Sara Lee (Callahan, 2003b). Similarly, at ConAgra Foods two salespeople also admitted to signing off on inflated amounts for manufacturer rebates due to U.S. Foodservice. ConAgra Foods claimed, however, that the erroneous confirmation amounts were discovered and that U.S. Foodservice's external auditor was notified before news of the accounting scandal broke (Callahan, 2003a). The forensic examination at U.S. Foodservice also revealed numerous weaknesses in internal controls, including failure to properly record and track vendor allowances, inadequate accounting and financial reporting systems for vendor allowances, and failure to follow GAAP (Ahold, 2003a).

The investigation revealed fraud at not only U.S. Foodservice, but also at several other Ahold subsidiaries and the parent company. It was discovered at one subsidiary that fictitious invoices were used to conceal payments, and in some cases, payments were improperly capitalized rather than expensed. It was also discovered that the consolidation of certain joint ventures into Ahold's financial statements was in error and that secret side letters had been concealed from Ahold's audit committee and external auditors. Further, accounting irregularities and earnings management were uncovered at other subsidiaries and at the parent company.

Overall, more than 750 separate items related to internal control weaknesses and accounting issues were identified at Ahold and its subsidiaries (Ahold, 2003a). This extensive forensic examination led to a lengthy delay in the announcement of 2002 audited earnings numbers. Ahold's 2002 annual report was released October of 2003, which included restatements for the years 2000 and 2001.

The total fraud at Ahold was revealed to be over \$1 billion. Of this, approximately \$856 million related to U.S. Foodservice. Upon conclusion of the forensic investigation, Ahold announced the creation of a task force reporting to the audit committee to address the internal control weaknesses and improper accounting practices uncovered during the investigation. (Ahold, 2003b). Ahold announced in their 2002 annual report that the internal audit department

would now report directly to the CEO and the audit committee, rather than solely to the CEO, as was the case previously (Ahold, 2002a).

According to press releases from Ahold, after the accounting scandal, U.S. Foodservice made “substantial improvements in the company’s financial systems and controls, as well as its financial organization, to strengthen financial monitoring and reporting” (Ahold, 2004). They also established a new office of governance, ethics and compliance.

LESSONS LEARNED: AUDIT CONFIRMATIONS

In designing the tests to be performed during an audit, an auditor must obtain adequate assurance to address audit risk. The greater the risk of a particular financial statement assertion (e.g., the existence and amount of vendor rebates), the more evidence an auditor should gather to support the assertion. Statement on Auditing Standards (SAS) No. 67 states that, “confirmation is the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions” (AICPA, 1992, SAS 67.06, AU 330). According to SAS No. 67, confirmation from an independent source is generally viewed as having greater reliability than evidence obtained solely from client personnel. Confirmation with a third party helps the auditor assess the financial statement assertions with respect to all five of management’s assertions: existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure. The auditor may design a third party confirmation to address any one or more of these assertions (AICPA, 1992). However, existence is usually the primary assertion addressed by confirmation of receivables.

Even though evidence obtained by a third party confirmation is generally viewed as being more reliable than evidence provided by the entity being audited, SAS No. 67 cautions that an auditor should maintain a healthy level of professional skepticism. The auditor should consider information from prior years’ audits and audits of similar entities. Further, an auditor has an obligation to understand the arrangements and transactions between the audit client and the third party so that the appropriate confirmation request can be designed. SAS No. 67 states that “[i]f information about the respondent’s competence, knowledge, motivation, ability, or willingness to respond, or about the respondent’s objectivity and freedom from bias with respect to the audited entity comes to the auditor’s attention, the auditor should consider the effects of such

information on designing the confirmation request and evaluating the results, including determining whether other procedures are necessary” (AICPA, 2002, SAS 67.27). The statement allows for the possibility that the party responding to the confirmation may not be completely objective or free from bias and requires the auditor to use other evidence to confirm financial statement assertions in such cases (AICPA, 1992).

Confirming accounts receivable is a generally accepted auditing procedure and is required unless the amount involved is immaterial, a confirmation would be ineffective, or if the auditor can substantially reduce the level of audit risk of the financial statement assertion through the use of other substantive and analytical tests. Accounts receivable, for the purpose of SAS No. 67 (AU 330), represent claims against customers that have arisen in the normal course of business and loans held by financial institutions (AICPA, 1992). The Statement does *not* specifically address confirming a receivable that arises when a vendor owes a rebate to a reseller, a situation that differs substantially from the typical trade accounts receivable from a customer. Confirming vendor rebate receivables give rise to different risks that likely were not envisioned when the Statement was adopted in 1992.

In adopting SAS No. 67, two (of the seventeen) Board members, while assenting to the Statement, expressed a reservation that the language used in the Statement usurped the freedom of the auditor in exercising professional judgment in how best to confirm accounts receivable and that the language might also lead auditors to place undue reliance on third party confirmation when circumstances might suggest that the auditor choose a more effective test (AICPA, 1992). With the benefit of hindsight it is clear that the auditors of U.S. Foodservice could have, and should have, designed a more “effective test,” one that would have helped overcome the inherent weakness that existed in this situation where parties providing the confirmation may have either been uninformed about the existence and/or amount owed to the retailer or may have had a vested interest to overstate the amount that was owed to U.S. Foodservice. While some practitioner literature has made reference to biases of confirmation respondents (e.g., Simunic 1996), scant attention has been given to this particular concern regarding responses to auditor confirmations by vendors’ sales personnel.

THE AFTERMATH

- In 2004, Timothy J. Lee and William F. Carter, both former purchasing executives for U.S. Foodservice, pleaded guilty to participating in the scheme and to conspiring with suppliers to mislead the company's auditors. They later agreed to pay approximately \$300,000 in civil penalties (Reuters, 2005).
- In 2006, U.S. courts approved a \$1.1 billion global class action settlement between Ahold and shareholders. However, as part of the settlement, Ahold denied any wrongdoing (Reuters, 2009). Ahold cooperated with investigators throughout the investigation and was not prosecuted by the United States government for the fraud.
- In 2006, Michael J. Resnick, former CFO of U.S. Foodservice, pleaded guilty and was sentenced to six months of home detention and three years' probation (Sterling, 2007).
- In 2006, Mark P. Kaiser, former U.S. Foodservice Executive Vice President of Marketing, was convicted of participating in the scheme. He was later sentenced to seven years in prison and ordered to pay a \$50,000 fine (Neumeister, 2007). However, in 2010, a federal appeals court ordered a new trial for Kaiser. At the time this case went to press, the new trial had not yet been scheduled.
- More than a dozen U.S. Foodservice vendors pleaded guilty from 2003 to 2006 to criminal charges related to the fraud, admitting that they submitted false confirmations to the auditors (Bloomberg, 2006). Many other U.S. Foodservice employees and vendors have faced civil charges from the SEC, and most have agreed to pay fines without admitting guilt (Sterling, 2007).
- In 2007, Suzanne Brown, former corporate controller at U.S. Foodservice, without admitting or denying wrongdoing, agreed to pay a \$100,000 civil penalty and accepted a five year ban on serving as an officer of a public company. She was also suspended from practicing as an accountant before the SEC for five years (Hughes, 2007).
- In 2007, former U.S. Foodservice CEO James Miller reached an agreement with Ahold in which Miller agreed to pay \$8 million but did not acknowledge liability (Kanner, 2007).
- Ahold sold U.S. Foodservice in 2007.
- In 2009, an appeals court in the Netherlands sentenced three former Ahold executives to suspended sentences and fines over the fraud at U.S. Foodservice and other foreign subsidiaries (Reuters, 2009).

- In 2009, the SEC dropped the charges against the two former KPMG auditors charged with having engaged in improper conduct during the 1999 audit of U.S. Foodservice (SEC, 2009). The auditors had been charged by the SEC in 2006 (SEC, 2006b).
- In 2007, Dutch Accounting authorities censured an employee of Deloitte & Touche for failing to fulfill his duties in the 2000 and 2001 audit (Sterling, 2007). In the United States, shareholder suits against Deloitte were dismissed in 2009 (SCAR, 2009).

QUESTIONS

- 1) *What lessons can be learned from the U.S. Foodservice case with regard to over reliance on third party confirmations?*
- 2) *What alternative substantive tests may have been available to the auditors of U.S. Foodservice? How do the alternate procedures differ from typical accounts receivable confirmations when confirming vendor receivables?*
- 3) *What mistakes were likely made by auditors of U.S. Foodservice and what responsibility does the auditor have to uncover fraud?*
- 4) *The FASB has reduced the wide latitude that companies once had in accounting for vendor rebates by issuing EITF Issue No. 02-16. What recommendations would you suggest to the FASB for further improving the accounting and auditing guidance in the area of vendor rebates?*
- 5) *Define professional skepticism. Do you think that the auditors of U.S. Foodservice exercised enough professional skepticism? Why or why not?*
- 6) *What is the difference between a financial statement audit and a forensic audit? When would each type of audit be performed?*
- 7) *Who acted unethically in this case? What were the consequences?*
- 8) *It appears that many people within U.S. Foodservice knew of the fraud and either helped perpetuate the fraud or at a minimum did not notify the auditors or regulatory agencies. What options were available to the employees who knew about the fraud and wanted to do something about it?*

REFERENCES

- Ahold, 2003a. 2002 Annual Report. The Netherlands.
- Ahold, 2003b, July 1. "Ahold announces completion of all internal forensic accounting investigations." *Ahold Press Release*.
- Ahold, 2004, July 27. "Former executives of Ahold's subsidiary U.S. Foodservice charged with past accounting fraud." *Ahold Press Release*.
- American Institute of Certified Public Accountants (AICPA). 1992. *Statement on Auditing Standards No. 67*. New York: AICPA.
- American Institute of Certified Public Accountants (AICPA). 2003. *Statement on Auditing Standards No. 99*. New York: AICPA.
- Association of Certified Fraud Examiners (ACFE). 2010. *Report to the Nations on Occupational Fraud and Abuse*. Association of Certified Fraud Examiners, Austin, TX.
- Ball, D. 2003, May 9. "Ahold will shave \$880 million off profit due to irregularities." *The Wall Street Journal*, B5.
- Bloomberg News, 2006, October 13. "U.S. Foodservice figure goes on trial."
- Bray, C., 2006, October 13. "Fraud trial over Ahold unit starts." *The Wall Street Journal*, C3.
- Bryan-Low, C. 2003, May 13. "Problems with vendor rebates may be broader than thought." *The Wall Street Journal*, C1.
- Bryan-Low, C., & M. Schroeder. 2003, February 27. "Deloitte & Touche is familiar with supplier-rebate issues." *The Wall Street Journal*, A7.
- Buckley, N. and J. Chaffin, 2003, March 4. "Jury issues subpoenas for Ahold papers." *Financial Times*, 26.
- Callahan, P. 2003a, April 4. "ConAgra says it quickly caught errors in Ahold unit's documents." *The Wall Street Journal*, A3.
- Callahan, P. 2003b, April 8. "Sara Lee employees signed faulty data on Ahold rebates." *The Wall Street Journal*, A8.
- Datson, T. 2003, February 26. "Financial sleuths move paper mountain in Ahold scandal." *Reuters News*.

- Financial Accounting Standards Board (FASB). 2002. FASB Emerging Issues Task Force No. 02-16: Accounting by a reseller for cash consideration received from a vendor. Norwalk, CT: FASB.
- Hughes, S., 2007, January 10. "Ex-Official at Ahold Unit Settles Case." *The Wall Street Journal*, C2.
- Kanner, J. 2007, December 19. "Ahold to get \$8 million in settlement over scandal." *International Herald Tribune*, 17.
- Masters, B. A. and R. J. McCartney, 2003, February 27. "Ahold Reported Scandal to Prosecutors; U.S. Opens Probes as Md. Unit Suspends 2." *The Washington Post*, E1.
- McClam, E. 2004, July 28. "Inflated earnings tied to 4 at Ahold." *The Philadelphia Inquirer*, p. D2.
- Neumeister, L., 2007, May 18. "7 years for former US Foodservice exec in securities fraud." *Associated Press Newswires*.
- Parker, 2003, February 25. "Deloitte says it warned company about problems." *Financial Times*, 24.
- Reuters News, 2005, January 11. "Two ex-Ahold unit execs settle SEC fraud charges."
- Reuters News, 2009, January 28. "Ex-Ahold executives sentenced in appeal over fraud."
- Safeway, Inc. 2003. 2002 Annual Report. Pleasanton, CA: Safeway, Inc.
- Securities Class Action Reporter (SCAR), 2009, January 31. "Securities fraud class action against Deloitte & Touche dismissed."
- Simunic, D. 1996. "Audit Confirmations." *CGA Magazine* (Toronto), Vol. 30, No. 5, May 1996, p. 18.
- Stecklow, S., S. Raghavan, & D. Ball. 2003, March 6. "How a quest for rebates sent Ahold on unusual buying spree." *The Wall Street Journal*, A1.
- Sterling, T. 2003, July 8. "Ahold offices raided as Dutch officials start criminal probe." *The Philadelphia Inquirer*, p. E2.
- Sterling, T., 2007, March 12. "Disciplinary court for Dutch accountants faults Deloitte in Ahold case." *Associated Press Newswires*.
- U.S. Securities and Exchange Commission (SEC). 2002. *Accounting and Auditing Enforcement Release No. 1581*. Washington, DC: U.S. Securities and Exchange Commission.

- U.S. Securities and Exchange Commission (SEC), 2006, February 16. “Administrative Proceeding File No. 3-12208” (Hall and Meyer)
- U.S. Securities and Exchange Commission(SEC), 2006, June 7. “Litigation Release No. 19721 SEC Charges Brady Schofield with aiding and abetting financial fraud at U.S. Foodservice subsidiary of Royal Ahold.”
- U.S. Securities and Exchange Commission(SEC), 2008, September 30. “Litigation Release No. 20760 SEC Charges East Coast Supermarket Operator Penn Traffic with Accounting Fraud.”
- U.S. Securities and Exchange Commission(SEC), 2009, December 14. “Accounting and Auditing Enforcement Rel. No. 3080.”

TEACHING NOTES

This case involves a real world fraud and audit failure, and details the subsequent forensic accounting examination. By completing this case, students can go beyond the level of detail typically included in a textbook. This case is appropriate for an auditing or fraud and forensic accounting course. We typically introduce the case after discussion of ethics as well as internal controls and fraud detection and we allow one week for the completion of the case questions. Students are given case materials starting with the Learning Objectives section and all the way to and including the References section.

The case is useful in helping students develop critical thinking and both oral and written communication skills. The case can be assigned either as an individual or a group project. We find that each solution takes approximately 15 minutes to grade. We typically devote one class period discussing the case and solutions. The instructor has the option of providing the students with the authoritative guidance on audit confirmations and promotional allowances or requiring the students to research this guidance themselves. We find it works well to provide the authoritative guidance for undergraduate classes and to have graduate classes do the research on their own. Students can read the EITF at <http://72.3.243.42/pdf/abs02-16.pdf>. Instructors have the option of telling students to cite the appropriate authoritative literature in their responses.

This case also provides an excellent opportunity for instructors to remind students of the ethical responsibilities of accountants. Numerous individuals in this case acted unethically and faced severe personal and professional consequences. We have found students to be very interested in this case, especially in the consequences to the individuals involved, from U.S. Foodservice employees to the auditors.

The Ahold annual reports for 2002 and other years are available at www.ahold.com.

SUGGESTED SOLUTIONS

The solution to this case can be obtained from the authors.