# UNITED STATES OF AMERICA Before the SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934 Release No. 52357 / August 30, 2005

ACCOUNTING AND AUDITING ENFORCEMENT Release No. 2300 / August 30, 2005

ADMINISTRATIVE PROCEEDING File No. 3-12021

In the Matter of

David P. Levine,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that ceaseand-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against David P. Levine ("Levine" or "Respondent").

II.

In anticipation of the institution of these proceedings, Levine has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Levine consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

On the basis of this Order and Levine's Offer, the Commission finds<sup>1</sup> that:

#### A. <u>RELEVANT ENTITIES</u>

#### 1. Kmart

**Kmart Corporation** ("Kmart" or the "company") was a Michigan Corporation headquartered in Troy, Michigan, during the relevant period. On January 22, 2002, Kmart filed a voluntary petition for reorganization relief under Chapter 11 of the Bankruptcy Code. The company's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange until December 19, 2002, when trading was suspended. Kmart's fiscal year ends the last Wednesday in January.

#### 2. Newell Rubbermaid

**Newell Rubbermaid Inc.** is a Delaware corporation headquartered in Atlanta, Georgia. Newell Rubbermaid Inc. is a Fortune 500 corporation and a major Kmart vendor. Subdivisions include EZ Paintr which manufactures and distributes paint applicator tools and related products. Newell Rubbermaid Inc.'s common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

#### B. RESPONDENT

**David P. Levine** ("Levine") was Kmart's Divisional Vice President for the Do-It-Yourself ("D.I.Y.") Division from April 1997 until July 2002.

#### C. FACTS

#### 1. Kmart Improperly Recognized Vendor Allowances

Kmart improperly recognized millions of dollars worth of vendor "allowances" prior to bankruptcy. Kmart obtained allowances from its vendors for various promotional and marketing activities. A significant number of allowances were recognized prematurely – or "pulled forward" – on the basis of incorrect information provided to Kmart's accounting department, while the correct terms of the payments were undisclosed. As a result of these accounting irregularities, Kmart's cost of goods sold was understated, and earnings were materially overstated, for the fourth quarter of fiscal year ended January 31, 2001 ("fiscal year 2000").

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<sup>&</sup>lt;sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## 2. Kmart's Vendor Allowance Tracking System ("VATS") Forms

The principal document involved in the pulling forward of vendor allowances was Kmart's Vendor Allowance Tracking System ("VATS") form. VATS forms summarized the basic terms of vendor allowances for the company's accounting department. Bookkeepers inputted information from the VATS form into the company's computerized accounting system, where it was eventually posted to the general ledger. To ensure proper accounting for an allowance, the VATS form should have reflected the correct effective dates for the payment. To pull forward an allowance, this information was incorrectly reported on the VATS form to make it look like the payment was for past performance, when it actually related to future obligations.

## 3. Levine Signed A Misstated VATS Form

In late calendar year 1997, Levine negotiated a contract with EZ Paintr, a Newell Rubbermaid subdivision, whereby Kmart agreed to purchase goods from EZ Paintr pursuant to various terms and conditions. The contract was executed on January 22, 1998 and expired at the earlier of: (1) Kmart's purchase of \$45 million of goods from EZ Paintr; or (2) December 31, 2001. The contract further allowed for various volume-based allowances from EZ Paintr to Kmart.

In late calendar year 2000, Levine began negotiating with EZ Paintr an addendum to the January 22, 1998 contract in order to extend the existing contract. On January 22, 2001, Levine and EZ Paintr's president executed a contract addendum pursuant to which EZ Paintr agreed to issue Kmart a credit memo in the amount of \$2 million titled a "2000 Promotional Fund" in exchange for Kmart's agreement to purchase an additional \$15 million in goods. Levine and EZ Paintr further agreed that if "during the life" of the addendum, Kmart exited the paint applicator business, the \$2 million would be refunded to EZ Paintr on a pro-rata basis.

In conjunction with the contract addendum, on or about January 29, 2001, Levine also signed VATS form No. 219052 which purported to account for the \$2 million allowance issued by EZ Paintr. However, the VATS form incorrectly reported the effective date of the \$2 million allowance as 2/1/00 to 1/30/01. Kmart's accounting personnel entered this incorrect VATS information into the company's computerized accounting system, where it was eventually posted to the general ledger. As a result, Kmart's cost of goods sold was understated by \$2 million in fiscal year 2000.

#### 4. Kmart's Earnings Were Overstated

On March 13, 2001 Kmart filed its Form 10-K for fiscal year 2000. According to the financial statements incorporated into the Form 10-K, Kmart reported net income for the fourth quarter of \$249 million or \$0.48 per share, exceeding Wall Street analyst expectations of \$0.47 by a penny. VATS form No. 219052 submitted by Levine caused net income for the quarter to be overstated by slightly less than 1 percent.

# D. <u>CONCLUSION</u>

As a result of the foregoing, Levine committed a violation of Rule 13b2-1 of the Exchange Act and caused Kmart's violation of Sections 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 promulgated thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Levine's Offer.<sup>2</sup>

Accordingly, it is hereby ordered that Respondent Levine cease and desist from committing or causing any violations and any future violations of Rule 13b2-1 of the Exchange Act and causing any violations and any future violations of Sections 13(a) of the Exchange Act and Rules 12b-20 and 13a-1 promulgated thereunder.

By the Commission.

Jonathan G. Katz Secretary

<sup>&</sup>lt;sup>2</sup> Levine has agreed to pay a \$35,000 civil penalty in connection with a parallel civil action.