

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 55383 / March 2, 2007**

**ACCOUNTING AND AUDITING ENFORCEMENT**

**Release No. 2569 / March 2, 2007**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-12577**

**In the Matter of**

**David C. Kirkpatrick,**

**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 cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against David C. Kirkpatrick (“Kirkpatrick” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Kirkpatrick 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, Kirkpatrick 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.

**III.**

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

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

**A. RELEVANT ENTITIES**

**1. Kmart Corporation (“Kmart” or the “company”)**

**Kmart** 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 [15 U.S.C. § 78l(b)] 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. Coca Cola Enterprises Inc. (“CCE”)**

**CCE** is a Delaware corporation headquartered in Atlanta, Georgia. CCE is the world’s largest bottler of Coca-Cola products and a major Kmart vendor. CCE’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**

**Kirkpatrick** was National Sales Director for CCE in charge of the Kmart account at all relevant times through January 2004, when he was asked to resign. Kirkpatrick worked out of a Farmington Hills, Michigan, field office during the relevant period.

**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 false information provided to Kmart’s accounting department, while the true terms of the payments were set forth in undisclosed side agreements. 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”).

**2. Kmart’s Vendor Allowance Tracking System (“VATS”) Forms**

The principal document involved in the pulling forward of vendor allowances was Kmart’s 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 true purpose of, and effective dates for, the payment. To pull forward an allowance, this information was misrepresented on the VATS form to make it look like the payment was for past performance,

when in truth it related to future obligations. Kmart had a number of safeguards designed to ensure the accuracy of the VATS forms and proper recognition of vendor allowances. These included the requirement that vendors co-sign VATS forms.

### **3. Kirkpatrick Signed Two Misstated VATS Forms**

At a meeting on or about January 5, 2001, Kirkpatrick learned that Kmart's food and consumables division needed \$5 million from CCE to help cover a divisional profit shortfall. As explained in a subsequent e-mail to Kirkpatrick on January 11, 2001, "dave, i appreciate your efforts however i need to accelerate your schedule. with the close of our fiscal on 1/31 i need to line up another partner. the bottom line is we need the 5.0m stay in touch." Kirkpatrick responded by e-mail, "[ ] How about 7:30AM on Tuesday 1/16/0[1]? I'll bring the donuts and the checkbook." Kirkpatrick attended additional meetings at Kmart in mid to late January 2001, after which CCE agreed to "advance" \$3 million worth of allowances in exchange for sales and promotional activities by Kmart during calendar year 2001 and to pay \$2 million to settle accounts for calendar year 2000. To memorialize that agreement, Kmart and CCE entered into a written contract dated January 30, 2001 ("Coke Contract"), which was negotiated by Kirkpatrick on behalf of CCE. The Coke Contract provided in relevant part that CCE would pay \$3 million to support mutually agreed-upon marketing activities during calendar year 2001. Kmart would earn this allowance if, and only if, it sold targeted amounts of CCE product during the calendar year.

At the end of January 2001, Kirkpatrick signed several VATS forms, including two relating to the \$3 million "advance." The first, VATS No. 226003, purported to relate to a \$2.25 million "Case display allowance" with an effective date of 02/01/00 to 12/31/00; the second, VATS No. 226004, purported to relate to a \$750,000 "Holiday Display activation" allowance with an effective date of 11/01/00 to 12/31/00. VATS Nos. 226003 and 226004 misrepresented the effective dates and purpose of these allowances. The true terms of the allowances were set forth in the Coke Contract and a subsequent letter Kirkpatrick wrote, neither of which was provided to Kmart's accounting department or independent auditor. As explained therein, CCE agreed to pay \$3 million to support mutually agreed-upon marketing activities during calendar year 2001.

On or about January 30, 2001, Kmart's accounting department entered the false VATS information into the company's computerized accounting system, where it was eventually posted to the general ledger. VATS Nos. 226003 and 226004 caused the cost of goods sold to be understated by approximately \$3 million in fiscal year 2000. CCE paid the \$3 million allowance by check dated April 4, 2001, but the money was subject to repayment if Kmart did not perform in accordance with the terms of the Coke Contract.

### **4. CCE's False Third-Party Confirmation**

Kmart's independent auditor, PricewaterhouseCoopers LLP ("PwC"), sought to confirm with CCE the terms of the \$2.25 million allowance during the fiscal year 2000 audit. Towards that end, PwC faxed Kirkpatrick a third-party confirm relating to VATS No. 226003 on or about February 19, 2001. The third-party confirm, which was on Kmart letterhead, read in relevant part, "Our auditors, PricewaterhouseCoopers L.P.P. are performing an annual audit of our financial

statements. They have requested of us to confirm directly with you the following vendor allowance agreement [Vats No. 226003].” On or about March 5, 2001, Kirkpatrick filled out by hand, signed, and faxed to PwC an executed third-party confirm that, as he knew or was reckless in not knowing, misrepresented the nature of (“Case display allowance”) and effective dates (“02/01/00 to 12/31/00”) for the \$2.25 million allowance.

**5. Kmart’s Earnings Were Overstated**

On March 13, 2001 Kmart filed its Form 10-K for the period ended January 31, 2001. 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. Kirkpatrick’s accounting irregularities caused Kmart’s net income for the quarter to be overstated by approximately 1.2 percent.

**D. CONCLUSION**

As a result of the foregoing, Kirkpatrick committed violations of Rule 13b2-1 of the Exchange Act and caused violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13b2-2 promulgated thereunder.

**IV.**

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

Accordingly, IT IS HEREBY ORDERED that Respondent Kirkpatrick cease and desist from committing or causing any violations and any future violations Rule 13b2-1 of the Exchange Act and causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13b2-2 promulgated thereunder.

By the Commission.

Nancy M. Morris  
Secretary

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<sup>2</sup> Kirkpatrick has agreed to pay a \$25,000 civil penalty in connection with a related civil action.