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Accounting fraud, business failure and creative auditing: A microanalysis of the strange case of the Sunbeam Corporation

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Abstract

This article closely examines the Sunbeam Corporation's path to failure and explores the reasons for its singularity. From the analysis of US fraud cases included in the *UCLA-LoPucki Bankruptcy Research Database*, this corporate case appears as an outlier. For Sunbeam, the time-lapse between fraud disclosure and its final bankruptcy is the longest of the entire sample; it is unique because of its length. This article uses a historical microanalysis to evaluate different hypotheses about the Sunbeam Corporation's path to failure. The relationships between acquisitions and fraud, 'scapegoat dynamics' and 'creative auditing' are identified as the most relevant issues to be examined against a changing institutional context. The resulting reconstruction of the events provides unexpected insights and recommendations for future research on auditing and accounting fraud.

Keywords

accounting fraud, creative auditing, failure path, historical microanalysis

Introduction

Accounting research, in dealing with the relationship between corporate fraud and failure, has gradually shifted its focus from predicting final bankruptcy (Altman, 1968; Beaver, 1968) to understanding failure as a process (Cybinski, 2001; Humphrey, 2008). Empirical studies have identified several determinants of fraud (Erickson et al., 2006), have investigated its duration (Baer, 2008; Erickson et al., 2011) and have estimated the probability of its disclosure according to different variables (Wang, 2013). However, there are still few studies about the complex interactions or relations between fraud and failure paths in changing institutional and historical contexts. Such relations elude aggregate statistical analysis.

The need for detailed qualitative contextual research on famous corporate scandals is highlighted by authoritative literature (Humphrey, 2005; Lee, 2004; Parker, 2005). This literature explicitly suggests bringing 'large scale corporate crash experiences under the microscope'

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(Parker, 2012: 67). Some scholars, however, have expressed doubts concerning idiosyncrasies in the significance of ethnographic case studies (Armstrong, 2008) and the arbitrary selection of historical facts (Kieser, 1994: 617–619). In order to avoid this, in this work, the authors purposely choose a case that questions the regularities identified by statistical analysis. They focus on the reasons for such a singularity and use the results to explore the limited scope of existing theories with a view to generating new hypotheses.

In a previous study, Agostini (2013) demonstrates that fraud disclosure usually leads firms to bankruptcy very quickly. The author performs a statistical analysis of the time between the date of fraud disclosure and that of bankruptcy in all the fraud cases listed by the *UCLA-LoPucki Bankruptcy Research Database*, including bankruptcies of US-listed companies from 1 October 1979 to 1 March 2010. The estimated survival function assigns a 75 per cent chance of falling into bankruptcy within 215 days after the date of fraud disclosure. The maximum length from fraud disclosure to bankruptcy is 840 days: this was the case with the Sunbeam Corporation, which emerges as the farthest outlier in the sample (Figure 1).

Taking as a starting point a dataset on bankruptcy, this article considers a case of finite time between fraud disclosure and final bankruptcy. The period of time (between fraud disclosure and final bankruptcy) can actually be finite or infinite (when the entity recovers without going bankrupt after fraud disclosure). Yet the possibility of a fraud without bankruptcy does not disprove the singularity of the inordinately long path to failure of the Sunbeam Corporation (considered here). This is the most evident exception to the statistical regularity of rapid failure after fraud disclosure (as identified in Figure 1): it represents a hybrid anomaly between finite (and usually short) and infinite time to failure.

The efficacy of considering ‘deviant cases’ has been emphasized in methodological debate within the social sciences from different perspectives (Emigh, 1997). More recently, Ermakoff (2014) has distinguished the different theoretical contributions of studying *anomalies* that challenge categories, *exceptions* that identify new objects of enquiry and *outliers* that make new connections visible. Interpreting these distinctions using the framework of a micro-historical approach (Fellman and Rahikainen, 2012; Magnússon and Szíjártó, 2013; Williams, 1999), the authors use the latter in this article to highlight the absence of expected elements and the presence or the visibility of aspects not considered in the literature. This makes it possible to question the general validity of explanatory models, to eventually identify the case as paradigmatic of a specific institutional and historical context and to explore the new heuristic perspectives it reveals.

Following this approach, all the available sources of information on Sunbeam Corporation are utilized, such as previous accounting studies, US Securities and Exchange Commission (SEC) enquiry reports, business columns, revised and unrevised financial statements, published interviews and previous studies, in particular the rich documentation collected in Byrne (1999b).[1] These information sources are examined to identify the specific features of the case that are pertinent to the theoretical debate on accounting fraud and failure. This multiplication of perspectives is deliberately aimed at avoiding simplification. The aim is ‘not to sacrifice knowledge of individual elements to wider generalization’ (Levi, 1992: 109). Only in this way can an ‘exceptional’ case shed light on broader trends. Furthermore, it can refute general assumptions and lay the foundation for new theoretical interpretations.

The authors have consequently built this analysis around the following research question: *What are the special features of the Sunbeam case that explain its exceptionally long path to bankruptcy?* A historical reconstruction of the events offers a pluralistic narrative, combining

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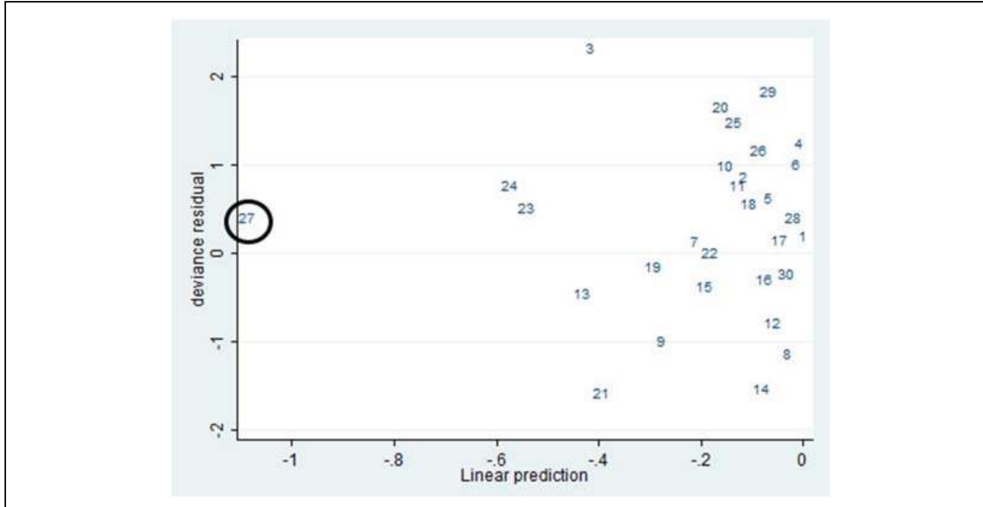

Figure 1. Statistical analysis of the time between the fraud disclosure date and the date of bankruptcy in the US fraud cases of the *UCLA-LoPucki Bankruptcy Research Database*. The number label '27' identifies the sample case of the Sunbeam Corporation; the survival function reveals that this company took 840 days (the maximum number of days of the sample) to fall into bankruptcy after the fraud disclosure.

different theoretical approaches, and permits us to identify the crucial explanatory elements of the case as follows: the strategy devised to commit and conceal the fraud, the attribution of responsibility after disclosure and the regulatory institutional context. In line with these considerations, section 'Review of the theoretical literature' reviews the literature on different fraud strategies, focusing on the role of auditors as 'scapegoats' and extending to auditing the concept of 'creative accounting'. After the case analysis, presented in section 'A microanalysis of the deviant case: comparing different narratives of the events', section 'Discussion: putting the case to work' illustrates the relationship among the variables in order to answer the research question and highlight the contribution of this article to the corpus of relevant accounting literature. Some concluding remarks summarize the main findings and implications.

Review of the theoretical literature

The starting point of this article is the exceptionally long timeframe from fraud disclosure to bankruptcy in the case of Sunbeam Corporation. The micro-analytical approach, adopted here, provides an opportunity to reference a wide set of literature covering different aspects of the theoretical debate. This allows an overall understanding of the complex evolutionary path, tracing the timeline from the commission of fraud, to its disclosure, and then to the company's bankruptcy.

In this respect, this work deals with a specific kind of fraud related to financial misstatement. This typology represents a minority of the total frauds occurring at global level. However, it makes up the absolute majority of reported losses, and it also takes the longest to be discovered (Association of Certified Fraud Examiners (ACFE), 2010: 10–14). Second, the article focuses purely on American fraud. In the United States (as in most Anglo-Saxon countries), accounting fraud seems mainly to be the result of pressure to perform that financial investors, market analysts and internal budgeting professionals exert over top and middle managers. Thus, the

notion of private benefit is only an indirect result of managerial conduct that aims, above all, to meet expected targets. Moreover, the role of executives' personal behaviour, as expressed in overconfidence in their choices, and the imperative of 'correcting' poor performance that could threaten their jobs (Schrand and Zechman, 2011) are particularly relevant in American cases.

Almost by definition, fraud is usually kept hidden by companies. Baer (2008) analyses the factors that lead manipulators to amend their conduct (if the fraud was not yet discovered). Shifting the blame to other people may represent one of the few conditions that lead the person committing the fraud to stop. Particularly interesting is the argument highlighting the presence of a 'linkage' problem. The accounts' manipulator anticipates a higher probability of being discovered if the fraud ceases. This pushes managers to resort to lobbying (Yu and Yu, 2011) or to mergers and acquisitions (M&A; Erickson et al., 2011) as a means to postpone or avoid fraud disclosure.

On the other hand, fraud disclosure triggers a scapegoating mechanism. It is interesting to analyse 'scapegoating' practices with reference to the anthropological literature, as have Guénin-Paracini and Gendron (2010). René Girard (1972, 2005) has argued that scapegoating arises as an escape route from the war of all against all that is typical of social crises. The scapegoat is identified as the only culprit for the turmoil through a process of mythification that makes possible a shift to a war of all against one. In their fear and anger, those involved want to identify the cause of the crisis. According to this perspective, over the last few decades the auditing function is being considered more and more often as holding responsibility for corporate scandals. Considering the case of Arthur Andersen in the aftermath of the Enron scandal, Guénin-Paracini and Gendron (2010) claim that auditors 'are often (but not always) selected as sacrificial victims in the wake of major corporate scandals' (p. 134).

Putting this observation into historical perspective, it can be seen that auditors were increasingly scapegoated in the early 2000s in connection with the increasing emergence of corporate scandals originating in the 1990s. In that period, a number of auditors were 'fined or settled out of court' (Jones, 2011). This seems to be perfectly consistent with the general evolution of fraud cases and legislative measures over the last decades, which focus more and more on auditing failure. However, the Sunbeam case demonstrates that in the immediate pre-Enron context, the events leading to corporate failure could also take a different direction when the auditors' behaviour and work make it possible to find another scapegoat.

Building upon the work of Guénin-Paracini and Gendron (2010), this article shows that the scapegoating mechanism can focus on different targets depending on the context. From that starting point, the authors provide here an explanation for a different fraud process, in which auditors are neither watchdogs, nor victims, nor legally guilty entities, and introduce the concept of 'creative auditing'. This represents one of the main foci of this work: it is the first comprehensive attempt, as far as the authors are aware, to identify another possible modality of auditing. This will be explained in detail, starting with the concept of 'creative accounting'.

Following the occurrence of famous accounting scandals which had a broad influence on the world economy, the concept of 'creative accounting' evolved through a set of legal opinions based on the flexibility of accounting policies. Several instances of this can be noted. Omurgonulsen and Omurgonulsen (2009) summarize them: creative accounting represents a process in which managers use their knowledge of accounting rules to manipulate reports. It also represents a set of undesirable practices that prevent people from seeing the true financial state of a company. Managers use creative accounting practices to manipulate profits to tie in with forecasts and to distract attention from news that would be harmful. Thus, creative accounting can be framed by and related to 'agency theory' (Amat et al., 1998). The first and most relevant feature of creative accounting is represented by its legitimacy: it is totally (formally) legal

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(Griffiths, 1986). Thus, an important differentiation (Jones, 2011) must be made between a fair presentation (i.e. non-tort practice), in which accounting flexibility is used to give a true picture of accounts so that they serve stakeholder interests, and creative accounting. In creative accounting, the same flexibility is used to manage the measurement and presentation of the accounts so that they serve mainly the interests of those who prepare them. Fraudulent reporting consists of deliberately stepping outside the regulatory framework to give a false picture of the accounts. It has been defined as 'an intentional misstatement of financial statements' (Arens et al., 2003). The three practices (i.e. non-tort, creative accounting and fraud) represent the different possible levels of use and misuse of accounting by managers.

The same distinction between practices has not yet been introduced in the literature for the auditing process. In the literature on fraud detection, the accounting and auditing functions have, indeed, followed different paths. However, even though they are separated from a temporal point of view, they are based on similar areas of research, such as those regarding the tools to improve fraud detection and the causes of failing processes. Thus, accounting practices (non-tort, creative accounting and fraud) implemented by managers may find a correspondence in the practices used by auditors, with the same escalation from productive to destructive methods. 'Creative auditing' may be framed by and related to agency theory in the same way as creative accounting. Auditors (agents) may use their professional knowledge, asymmetrical information and the flexibility of auditing rules to distract the attention of the principals (owners, shareholders and investors) from news that would be harmful, if not catastrophic. In fact, according to agency theory, information asymmetry occurs when agents enjoy a competitive advantage over principals because of the information they have about the company. Information within an organization is critical, and auditors working with the management of a company are aware of essential information that can be used in a legal but possibly unethical way to maximize their own interests at the expense of the principals. This results in the principals' inability to control what they might reasonably expect to be the actions of the agent (Strausz, 1997). Such a situation is worsened by the shareholders' limited roles in public companies (Brown, 2007). As a result, the possibility arises of collusion between auditors and managers (Olsen and Torsvik, 1998; Tirole, 1986). Major streams of literature recognize that the main causes of audit failures lie in the audit expectation gap (Porter, 1993; Salehi, 2011) and in the lack of auditors' independence. Recent regulations (such as the Sarbanes–Oxley Act in the United States) have tried to reduce both of these.

Based on these premises, in the following paragraphs, the authors develop the concept of creative auditing as a tool to interpret and understand the particular role of auditors (in relationship to both managers and shareholders) in the case of Sunbeam Corporation.

A microanalysis of the deviant case: comparing different narratives of the events

The Sunbeam Corporation case clearly represents an example of accounting fraud. It had been producing electric home appliances since 1910. In the early 1990s, the company had some problems due to poor performance and to a lost lawsuit against a former CEO, who was fired in 1992. Thus, when Albert J. Dunlap became Sunbeam's CEO in July of 1996, it was in the hope that this appointment would represent a turnaround for the company; Sunbeam's stock soared by nearly 50 per cent the day Dunlap was hired to run the company in 1996, and its reported profits soared in 1997. At that point, Dunlap orchestrated a fraudulent scheme to create the illusion of a successful restructuring of Sunbeam to facilitate the sale of the company at an inflated price. The milestones of Sunbeam's path to failure are tabulated below (Table 1).

Table 1. Sunbeam Corporation's failure path: a chronological table of main events.

Date	Event
July 1996	Albert Dunlap becomes Sunbeam's CEO.
	Aggressive downsizing and cost-cutting strategies are implemented.
October 1996	The accounting fraud begins.
	Improper recording of bill-and-hold sales, use of 'cookie jar' reserves to inflate 1997 accounting results, 'channel stuffing' by shipping unsold inventory to retailers.
September 1997	The attempt to sell the company fails.
	Stock attains premium levels.
March and April 1998	Three companies (Coleman, First Alert and Signature Brands) are acquired by Sunbeam Corporation.
	Debt load following the acquisitions is covered with a loan from a bank consortium.
June 1998	Laing's article is published, the accounting fraud emerges and Dunlap is forced to resign.
	Jerry Levin becomes Sunbeam's CEO.
	Reorganization focuses on fostering accountability at business-unit level, improving product quality and consumer services.
February 2001	The decline of sales due to the slowdown of the US economy in 2000 makes it impossible to refinance corporate debt.
	Sunbeam files for Chapter 11 protection.
	It will emerge from Chapter 11 in December 2002 as American Household Corporation.

The first point concerns the mechanisms of governance internal to the Sunbeam Corporation. The new CEO in 1996 enjoyed full powers; four of the five board members were chosen by Dunlap himself (the fifth was a main shareholder, Michael Price). In the following year, half of Sunbeam's 12,000 jobs were eliminated, approximately 90 per cent of the products were discontinued and 18 of the 26 plants were closed (*The New York Times*, 1997). In fact, the new CEO, also known as 'Rambo in Pinstripes' for his aggressive downsizing and cost-cutting attitude (Dunlap, 1996), implemented the same strategies he had already successfully applied when he headed other companies, such as Scott Paper Company. He ordered massive cuts to product lines, plants and employees (Lublin and Brannigan, 1996). The implementation of these same actions excited analysts' expectations for higher profits, pushing the stock to over US$45 per share in September 1997.

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At this point, Dunlap thought he was ready to sell Sunbeam (as he did with Scott Paper Company), but the sale could not be concluded, despite numerous attempts by Sunbeam's investment bankers. This strategy (SEC, 2001a, 2001b) misfired because Dunlap's celebrity pushed Sunbeam stock to premium levels, making it too expensive for most acquirers and making the sale of the company itself impossible (Hill, 1999; Laing, 1998).

As highlighted by Byrne (1999b), after the failure to find a buyer, Dunlap decided to use Sunbeam's inflated stock to leverage money and to acquire other companies. In March 1998, Sunbeam acquired control of Coleman Inc., in part by means of an exchange of shares (Kadlec, 1998). In April 1998, Sunbeam also bought, for cash, First Alert, Inc. and Signature Brands, Inc. In doing so, Sunbeam assumed a very large amount (around US$700 million) of previous debts

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of the acquired companies (Canedy, 1998b). In order to cope with these debts, Sunbeam was granted a US$1.7 billion loan from a bank consortium (Brennan, 2001).

The second point in Table 1 regards the accounting fraud. In April 1998, after the acquisition of the three companies mentioned above, there was a first warning of a slowdown in quarterly sales (Figure 2), and 'Sunbeam began to publicly unravel' (Byrne, 1999a). A wholly different story came to light: 'At least $62 million of Sunbeam's reported income of $189 million came from accounting fraud' (SEC, 2001a: clause III). Among the many different fraudulent accounting techniques used by Sunbeam from October 1996 to June 1998, the SEC focused on 'the improper recording of bill-and-hold sales'. Moreover, Dunlap's claimed that reorganization was based on several other improper practices, such as using 'cookie jar' reserves to inflate the accounting results of 1997 and 'channel stuffing' (shipping inventory before delivery or final acceptance) to reduce the value of inventory and to record large immediate profits.

Sunbeam was increasingly in difficulty due to its efforts to keep up with market expectations and with the expectations of the CEO himself (Byrne, 1999b). Dunlap was, indeed, setting unattainable goals, such as doubling sales in 3 years and increasing operating margins from 2.5 to 20 per cent. Employees' testimonies and complaints, collected by Byrne (1999b), reveal that Dunlap urged his subordinates to do whatever they could to reach almost impossible targets on pain of dismissal, but that he was also offering them much larger rewards in stock options than any other company if they met their goals. According to Sunbeam's employees, 'almost all executives believed these goals were impractical', but they did not refuse their wage incentives (Byrne, 1999a).

The fifth historical milestone (listed in Table 1) pertains to the fraud disclosure. By June 1998, when Sunbeam's stock had fallen to around US$22 per share following the tumble in profits, an analyst from *Barron's Online* (Laing, 1998) was the first to investigate, in detail, the reasons for such a sudden drop. Jonathan Laing's article disclosed that Sunbeam had realized a negative operating cash flow in 1997 and insinuated that the company implemented questionable accounting practices (Norris, 2001a). Although several analysts still continued to believe in Sunbeam and its CEO, the company soon made a radical choice. The first decision (8 days after *Barron's* discrediting article) resulted in Dunlap's forced resignation, both because of this negative publicity and due to employees' assertions about his working methods. By June 1998, the company's directors had fired 'Chainsaw Al', commenting that they had 'lost confidence' in his leadership abilities (Mahabaj, 1998). Ronald Perelman, the former majority shareholder of the first company acquired by Sunbeam, was able to gain the confidence of the board and to name Jerry W. Levin as Dunlap's successor in an attempt to salvage Sunbeam. Levin had been the CEO of Coleman from 1989 to 1991 and again from 1997 to March 1998 (when the company was sold to Sunbeam). After taking office at Sunbeam in June 1998, Levin announced that a restatement of the 1997 results was forthcoming in order to recover from 'Chainsaw Al' and that the company had no intention of going bankrupt (Connor, 1998). On 20 October 1998, Sunbeam announced the restatement of the results from the last quarter of 1996 through to the first quarter of 1998. Sunbeam's 1997 net income was decreased by US$71 million, and 1997 operating expenses were mostly attributed to the previous year (US General Accounting Office, 2002: 201). Dunlap argued that this restatement concerned 'technical accounting issues' (Canedy, 1998b; Stanwick and Stanwick, 2003), which had been, or should have been, revised and approved by Sunbeam's external auditors.

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The announcement raised some questions about the position of external auditors. In most fraud cases, auditors declare that they had no knowledge of the improper accounting practices used by the company. The Sunbeam case is unique because Phillip E. Harlow, the Arthur

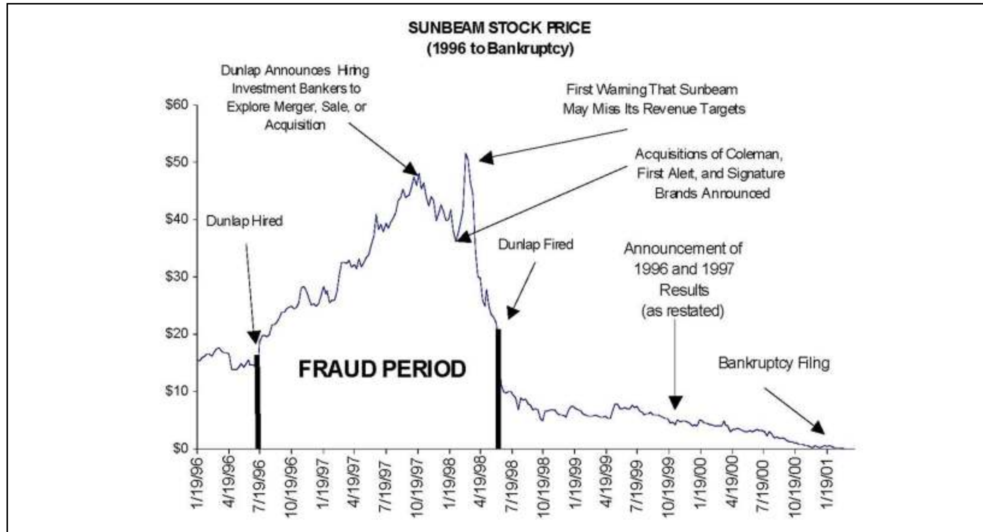

Figure 2. Sunbeam's stock chart. The chart shows that public investors, ranging from individuals to investment funds, who bought and held Sunbeam's stock in anticipation of a true turnaround, lost billions as a result of the scheme.
Source: SEC (2001b: clause 8).

Andersen partner in charge of the Sunbeam audit, had discovered some of the fraudulent transactions and asked the company to change its financial statements. In particular, Harlow focused on a specific fraudulent method of creating fake profits, the so-called 'spare-parts gambit' (Norris, 2001b). Sunbeam stored many spare parts 'in the warehouse of a company called EPI Printers, which sent the parts out as needed' (Norris, 2001b). According to Sunbeam's 1997 financial statements, these parts were sold for US$11 million to EPI, with US$8 million of profit, while EPI was actually ready to pay only US$2 million. This was possible because of an 'agreement to agree' signed by EPI with an escape clause. The deal was never closed, but the profit was booked. External auditors claimed to have effectively discovered this misstatement and concluded that it should have been modified, but Dunlap refused to make most of the requested changes. As a result of the negotiation between the auditors and the CEO, Sunbeam agreed to cut the profit by just US$3 million. After that, before deciding to sign, Harlow analysed Sunbeam's financial statements thoroughly and understood 'that the remaining profit was not material'; this was the same as saying that 'the part of profit that was not presented fairly did not matter' (Norris, 2001b). After the disclosure of the Sunbeam fraud, Harlow was supported by his firm (Arthur Andersen), which held that the case did not involve fraud but concerned 'professional disagreements about the application of sophisticated accounting standards' (Norris, 2001b). These disagreements actually made reference to an old 'rule of thumb' that the immateriality of misstatements was acceptable when their amount was below a predefined threshold level (5%–10%) of disclosure (Jennings et al., 1985). Sunbeam's external auditor applied such a rule and considered materiality as a percentage of total income:

> In the typical accounting fraud case, the auditors say they were fooled. Here, at least according to the SEC, the auditors discovered a substantial part of what the commission calls 'sham profits'. (Norris, 2001b)

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In fact, after Dunlap was fired, Arthur Andersen, along with another accounting firm, re-audited the books and concluded that not only should the 1997 profits have been far lower but also that Sunbeam's external auditors acted in a different way from the typical auditor in a typical accounting fraud. Indeed, after the bankruptcy of Sunbeam in 2001, following a class action lawsuit by shareholders and bondholders, Arthur Andersen was accused (only) of failing to exercise appropriate scepticism while conducting Sunbeam's audits. The auditors paid up, but without admitting fault or liability. Dunlap was banned from ever serving as an officer or director of a public company because of his actions as Sunbeam's CEO.[2]

The sixth (and last) historical milestone (listed in Table 1) was formal bankruptcy. Sunbeam filed for Chapter 11 bankruptcy protection on 6 February 2001, so marking the end of the very long 840-day path from Sunbeam's fraud disclosure to bankruptcy. During the 2.5 years before this final event in its failing path, the company struggled to recover under the direction of Levin and of the new senior management team he appointed. This included some of the executives who had previously worked with him at Coleman, together with former Sunbeam managers and newly recruited experts in marketing and brand building.

In August 1998, Levin announced a new strategy, aiming at 'decentralizing operations', improving 'accountability at the business unit level' and 'increasing quality in products and consumer service' (Sunbeam Corporation, 1998). The company was reorganized into three operating groups (Outdoor Leisure, Household Products and International), plus a Corporate Group providing support services. As part of the reorganization, the company discontinued Dunlap's decision to close eight plants, keeping four of them open 'to ensure a high level of quality and customer service, as well as a consistency of supply'. In clear opposition to the 'Chainsaw Al' approach, Levin declared, 'we won't destabilize our brands, product quality and customer relationships by cutting too fast and too far' (Sunbeam Corporation, 1998).

The most relevant difficulties the company faced at the time were considered consequences of previous management choices. The fraudulent 'channel stuffing' practices had resulted in a huge increase of the inventory of some specific products. The need to sell off this inventory was expected to heavily affect the company's results. For this reason, the already announced dividend was cancelled in August 1998. Sunbeam was also burdened with a US$2.2 billion debt, largely resulting from the recent acquisitions (Brannigan, 2002): Levin was able to negotiate a waiver on loan covenants pushing the deadline for reimbursement forward to April 1999 and, subsequently, to April 2000 (Ferrell et al., 2009; Sunbeam Corporation, 2000: 10).

The confidence of the Board of Directors in the strategy devised by the new CEO was confirmed at the end of March 1999: Levin was appointed as Chairman (Sunbeam Corporation, 1999). At that point, the stock was recovering slightly (Atlas and Tanner, 2001), but its value started to deteriorate again in the following year because results were not improving as expected.

In January 2000, a new restructuring plan was announced, combining appliances and personal care items into a broader household products business unit, which would also manage healthcare products. Analysts declared that the move made sense, but was not addressing the crucial issue of refinancing the company's still enormous debt (Friedlin, 2000). The further extension allowed to the company in April 2000 was conditional on a minimum cumulative earnings before interest, tax, depreciation and amortization (EBITDA) to be tested at the end of each month (Sunbeam Corporation, 2000: 10).

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After a growth of 3 per cent in the first quarter, in the second and third quarter of 2000 sales decreased by almost 10 per cent, mostly due to general economic weakness and a consequent slowdown in consumer spending. Sunbeam consequently failed the EBITDA test in the third quarter of 2000, and Levin reached a new agreement with creditors in November. In case of

failure to attain the adjusted monthly minimum EBITDA in the first quarter of 2001, there was 'no assurance that the Company could obtain a waiver or amendment' (Sunbeam Corporation, 2000: 11). The stock price of Sunbeam started deteriorating in the Fall of 2000, and the company ran short of cash. In January 2001, the New York Stock Exchange delisted the company's stock for not complying with minimum listing criteria. The announcement of the decision to file for Chapter 11 bankruptcy protection followed shortly after, in February 2001, as Sunbeam did not meet the minimum EBITDA in January, and it proved impossible to obtain a further waiver.[3]

The Board, then the new CEO and his managerial team had tried to avoid bankruptcy with many instruments and plans, but, in the end, their best efforts failed: the burden of debt proved insurmountable in the changed economic situation of the early 2000s. Further emerging scandals and a consequent stricter enforcement of new accounting regulations were then added in to undermine business confidence. This explains why the time-lapse to bankruptcy after fraud disclosure, even if very long, was not infinite. After such a disclosure, the delay of bankruptcy was initially made possible by the scapegoating of the CEO, in a context complicated also by creative auditing practices. In the following section, we will analyse the connections between these different factors.

Discussion: putting the case to work

This section re-addresses the research question posed in the Introduction and focuses on the explanatory items we have identified The authors will use the results of the SEC investigation and other above-mentioned sources to build a complex yet clear model of what happened. This focuses on the interacting factors explaining the exceptional features of the Sunbeam case. Such items, which are usually discussed in the literature individually, have been analysed through their interactions (Parker, 2012). In this way, the microanalysis of the case provides useful insights into the contingent nature of causal mechanisms. This permits the authors to return to the various general lessons that can be extracted from the case. The authors highlight a combination of three anomalies (expected features that are missing, contradicting existing models) in the failure path of Sunbeam Corporation. First, the failed sale of the company emphasizes a usually 'invisible' point about the much-studied connection between M&A and fraud (Erickson et al., 2011). Second, after the fraud disclosure, the scapegoat is identified as the CEO, allowing a tentative restart of the company and the delay of its bankruptcy. Third, the opportunistic use of auditing regulatory flexibility ('creative auditing' practices) does not imply auditors' involvement in the corporate fraud after its disclosure and before the final bankruptcy. In the following, each point is considered in detail.

The first point, the failed sale of the company, is related to the over-manipulation of accounting. As shown before, the motive for overstating Sunbeam's performances lay in the gap between the actual economic results of the company and the exaggerated financial expectations. Dunlap pushed his management to make systematic use of 'boosting' practices, which is accounting fraud. The pervasiveness of such behaviour inside the company is explained by the higher-than-usual number of stock options in all the managers' pay. Both top and middle managers found stronger and stronger incentives to boost reported performances (Bar-Gill and Bebchuk, 2002; Erickson et al., 2006; Goldman and Slezak, 2006). Yet, the peculiar effects of Sunbeam's performance overstatement are even more interesting than the general causes leading to such overstatement. The increase in the stock price was so high that it eventually prevented Dunlap from selling the company. This point raises a theoretical problem: What does it mean when the price of a company's stock exceeds the threshold for selling the company itself?

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Following the account of the events as reported above, this paradox may be interpreted as the result of an inverted premium for control. Buyers discounted the fact that the company, once acquired, would lose its best non-replicable 'intangible asset', the CEO himself. In any case, they did not believe those high performances were replicable.

The motivations that have been assigned to the attempted sale of the company lead to an examination of the heuristic role the case can perform, highlighting the conditions that could have allowed Sunbeam's fraud to go undetected. In fact, if the sale of the company had been realized, it would have represented the final step of the process of reorganization and fraud implemented by Dunlap. In the CEO's intentions, according to a possible logical reconstruction, such sale, if carried out, would be covered by the 'veil of acquisition' of all the problems that might have emerged from the inaccurate and inappropriate accounting practices preceding it.

Recent studies show that companies accused of committing accounting fraud are more prone to buy other companies (Erickson et al., 2011). In fact, they use acquisition as a stratagem to conceal the fraud itself or at least to delay its disclosure. The analysis of the present case prompts the hypothesis that companies committing fraud might view the acquisition of other companies only as a second-best strategy. As the sale of the company became impossible, Dunlap resorted to the second-best strategy of acquiring other companies as an alternative tool for concealing accounting fraud and using overvalued company stocks as a financial lever to obtain the money to invest in the acquisitions. He would have preferred Sunbeam's sale, as selling seems to provide a more successful cover-up of previous fraudulent accounting than acquisition. Thus, the historical financial statements of acquired companies may be a rich source for the investigation of possible undisclosed frauds. Sunbeam's stated performances began showing some difficulties only 2 months after the triple acquisition because of the impossibility of taking the boosting practices (described above) too far. The results were a loss on the 1998 first quarter report and a consequent decline in the stock price. This attracted the attention of Laing (1998), whose analysis for *Barron's Online* alarmed the board. Dunlap was fired after a rapid inspection of the second-quarter results. This sequence of events confirms that analysts are effective whistle-blowers of frauds (Dyck et al., 2006), yet their actions are usually triggered by market signals.

Dunlap's forced resignation emphasizes the importance of the second listed item, that is, the 'scapegoating' of the CEO. By blaming Dunlap alone for the fraud, Ronald Perelman tried to avoid bankruptcy putting Levin in charge of a tentative recovery. The new CEO was able to complete the company reorganization, which failed as the general economic conditions changed. The economic contraction of the first and third quarter of 2001 jeopardized demand and prevented the company from returning to profitability, causing it to collapse under the debt burden accumulated with the acquisitions. Perelman's strategy and Levin's attempt represent the factual explanation of Sunbeam's exceptionally long trajectory to bankruptcy. Shareholders hoped to be reimbursed for their losses by supporting the idea that the only fraudulent actor was Dunlap. So, in the present case, Dunlap's scapegoating represents the act of making a single person guilty for what was certainly a more complex process, even when the undeniable direct responsibilities of the 'scapegoat' are taken into account.

The scapegoating of the CEO also implies that the auditors were not initially held responsible for the fraud, even though they were aware of misstated profits. In particular, by stating the immateriality of a part of improper profits after a negotiation with directors, they used their professional knowledge, their asymmetrical access to information and the flexibility inherent in auditing rules to distract other stakeholders' attention from news that would reveal fraud. For these reasons, the authors can confirm the implementation of *creative auditing* in the Sunbeam case.

From this perspective, the case of Sunbeam may be a residual example of the blind alley down which auditing practices had been heading at the turn of the millennium. The later financial scandal surrounding the collapse of Enron would indeed lead to the demise of Arthur Andersen, which was both Sunbeam's and Enron's external auditor. Its involvement in Sunbeam's case and other previous fraud cases caused prosecutors to consider it a recidivist offender. Thus, one may ascribe the particular behaviour of the auditor in the Sunbeam case to Andersen's specific 'firm culture' (Carpenter et al., 1994). However, some studies suggest that Andersen's way of working was not significantly different in quality from that of other auditing firms (Cahan, Zhang, and Veenman, 2011). For this reason, it may be supposed that it was more a matter of a 'period culture' (rather than of a specific 'firm culture') in the auditing profession.

This hypothesis is supported by the introduction of new regulations after further comparable financial scandals following Sunbeam's path to failure. Indeed, such events resulted in a 'crisis of confidence' in American capitalism, which led to wide-ranging debates, culminating in the Sarbanes–Oxley Act of 2002. The latter reformed and strengthened the regulation of accounting, auditing and corporate governance (Buckhoff et al., 2010; Raiborn and Schorg, 2004). So the implementation of *creative auditing* in the Sunbeam case represents a temporary condition that impinged on its failure path. This does not imply that creative auditing is no longer possible in any shape or form; certainly, new regulations, starting with the Sarbanes–Oxley Act, filled some holes in the legislation. Yet, the bounded nature of rationality implies an unavoidable residual incompleteness. Opportunistic agents did and surely will again exploit it in several ways.

Conclusion: implications and findings

This article investigates a single case, which emerged as an outlier (from a database of bankrupted American firms) because of the length of time from its fraud disclosure to its bankruptcy. This article closely examines this unique path to failure in a way that would be impossible with a larger dataset. The analysis shows that this case is the result of the interaction of normal and exceptional features; there is a series of complex connections between fraud, market performance, M&A choices, auditing and effects of fraud disclosure.

The authors used a micro-historical method to infer some implications about general mechanisms regarding fraud and company failure. First, the authors focused on *anomalies*, shedding a critical light on existing explanatory models. The second focus centred on the heuristic function of an *outlier*, highlighting usually undetected features, and the third centred on its paradigmatic role as an *exception*, identifying other possible patterns (Ermakoff, 2014).

Regarding the first point, in Sunbeam's case, the CEO was scapegoated by shareholders, as well as by employees and auditors, with a view to avoiding immediate bankruptcy. With regard to the second point, the authors identify and describe an unacknowledged mechanism that allows fraud to go undisclosed. Buyers usually prefer not to denounce fraud if they discover it after acquisition. Such a mechanism is detectable here because of a particular contingency; the company's stocks became too expensive to make a sale possible, so the company decided to acquire other entities. The owners of the newly merged company could not hide the fraud, so they minimized it, scapegoating the CEO and delaying bankruptcy. This explains the long time-lapse between fraud disclosure and bankruptcy. This situation also led to an exoneration of the auditors.

Regarding the third point, the authors finally observed that this peculiar combination of events was possible only before 2002; the Enron scandal represents a historical turning point for auditing regulation.

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From these findings, one may draw two main general implications for further research. First, the authors identify a possible mechanism that allowed the fraud to go undisclosed after the successful sale of the company. It will be interesting to check the frequency of historical cases of undetected fraud on a dataset that collects data on sold companies. The detailed analysis of financial data can highlight undisclosed manipulations and integrate probable estimations about such cases (Wang, 2013). Second, as far as the authors are aware, this is the first comprehensive attempt to define the concept of 'creative auditing'. Creative auditors exploit their professional knowledge, asymmetrical information and the flexibility of auditing rules to negotiate and collude with directors. As opportunistic agents, directors do this to distract the attention of principals (stakeholders) away from unwelcome news; this results in the principals' inability to exercise control over the desired action of the agents. Indeed, auditors have access to essential information about the business organizations they audit. In this case, they used it in a then legal, if unethical, way to maximize their own interests at the expense of the stakeholders. Even if the opportunistic practices they used are no longer legal, new ones may emerge, both now and in the future. This supports recent claims for the triangulation of audit evidence to detect financial fraud (Trotman and Wright, 2012). Moreover, creative auditors may have used different mechanisms in the past; this invites further enquiries on how auditors could exploit the flexibility of standards in different historical contexts.

Acknowledgements

The authors acknowledge the financial support provided by the Department of Management of Ca' Foscari University of Venice in the proofreading stage. They are also grateful to Stephen T. Limberg and Paul Miranti for their encouragement and comments on a very early version of this paper. Two anonymous referees provided very useful suggestions. The usual disclaimer applies.

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Funding

The authors received financial support from the Department of Management of Ca' Foscari University of Venice for the proofreading of this article.

Eliminato: The author(s) received no financial support for the research, authorship and/or publication of this article

Notes

1. John A. Byrne's (1999b) book *Chainsaw: The Notorious Career of Al Dunlap in the era of Profit-at-Any-Price* has been an invaluable source of information. It is a well-documented narrative, enriched with many interviews, which focuses on Al Dunlap's career and character. It emphasizes Dunlap's greed and strong personality in downsizing corporations for short-term shareholder profit. The aim of the book seems to be the provision of a specific lesson: bad leadership can destroy shareholder value and people's lives. Its purpose is therefore different from the present work, which is not simply descriptive, and does not tell the full story of Dunlap's career. This article is, in fact, more focused on theoretical and methodological issues. It implements a hybrid methodology, involving a blending of historical and empirical research methodologies, closely examining Sunbeam Corporation's path to failure after selecting it as an outlier from a large sample, according to an original and empirically based procedure. Sunbeam Corporation's path is analysed here in order to investigate the reasons for its singularity (i.e. exceptionally long time from the fraud disclosure to the final bankruptcy) and to highlight the limiting parameters of accounting models in use (and possible unobserved mechanisms). This leads the authors to propose a new theoretical definition of creative auditing as a key to interpreting recent historical changes in the relationship between fraud and bankruptcy in the United States.

2. He also paid US$15 million to settle a class action suit filed by investors in January 2002 and US$500,000 to settle US Securities and Exchange Commission (SEC) charges in September 2002 (Brannigan, 2002; Norris, 2002).
3. Sunbeam rapidly emerged from Chapter 11 in December 2002 and changed its name to American Household Corporation. Levin remained as a CEO until the new company was sold to Jarden Corporation in September 2004.

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