

INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 5 | Issue 4

2022

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An SEC Case Study of Manitex International, Inc. Securities Fraud Using “Bill and Hold” Sales to a Related Party to Overstate Revenue

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ABSTRACT

This is a case study of In the Matter of Manitex International, Inc., an administrative cease-and-desist proceeding conducted by the U.S. Securities and Exchange Commission (SEC) on September 29, 2020. The specific issues covered in this case include (a) the elements of several types of securities fraud according to U.S. federal law; (b) how corporate officers of Manitex carried out two fraud schemes over several years resulting in the pilferage of inventory and the use of “bill and hold” (b&h) sales to overstate revenue; (c) what is meant by a b&h sale; (d) the legal requirements which would justify the inclusion of b&h sales in the revenue of a company; (e) why a b&h sale to a related party deserves special scrutiny; (f) the legal duty of corporate officers of an issuer to maintain a system of effective financial reporting and internal accounting controls; (f) whether corporate officer defendants are required to have accounting expertise to be held liable for securities fraud; (g) whether a restatement of financial statements is ample justification for disgorgement of a corporate officer’s bonus; and (h) implications for auditors emanating from this case.

Keywords: securities fraud, inventory theft, “bill and hold” sale, overstated revenue, related party

I. GENERAL PROBLEM

The problem in this article is to study the SEC cease-and-desist proceeding titled *In the Matter of Manitex International, Inc.* and to focus on: factors indicative of overvaluation of a firm’s revenue due to recognition of b&h sales, how a business firm’s internal controls (or lack thereof) impact a securities fraud case, the legal elements required to prove several types of securities fraud, whether it is essential for a defendant in a corporate securities fraud case to have accounting expertise in order to show actual knowledge of an accounting violation, and implications for auditors emanating from this case.

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II. REVIEW OF THE LITERATURE: WHETHER A FIRM'S REVENUE RESULTING FROM A "BILL AND HOLD" SALE IS LEGALLY RECOGNIZABLE OR IS A FORM OF ILLEGAL SECURITIES FRAUD.

Only a handful of business journals have addressed this issue. Lord (2010) briefly mentioned "bill and hold" (b&h) sales as one form of corporate fraud in a general call for academics to be more mindful of fraud issues.² Alturki (2020) listed b&h sales as one type of occupational fraud that is perpetrated inside business processes and described business processes as being crucial in the attainment of an organization's strategies to achieve organizational goals.³ Erguden (2020) analyzed whether Turkish tourism companies were in compliance with International Financial Reporting Standards relating to the recognition of revenue, and used b&h sales as one example of a practice which would violate those standards.⁴

Law journals have covered the issue of b&h sales somewhat more than business journals. Warren (2003) discussed the corporate counsel's perspective on a firm's revenue recognition and b&h transactions.⁵ Fisher (2003/2004) covered what corporate counsels failed to do regarding revenue recognition and b&h sales in Enron and other scandals that occurred around the turn of the millennium.⁶ Weiss & Berney (2004) advised on how to restore investor trust in auditing standards and accounting principles in the aftermath of those scandals.⁷ Whitestone (2005), also writing in the wake of those scandals, explained the issue of whether principles-based accounting standards were more effective at preventing financial fraud.⁸ Deming (2006) highlighted the efficacy of the Foreign Corrupt Practices Act in the prevention of white-collar crime.⁹ Hill (2012), writing in the aftermath of the 2008 Financial Crisis, analyzed whether the

² Lord, A. (2010). The Prevalence of Fraud: What Should We, As Academics, Be Doing To Address the Problem? 9:1 *Accounting and Management Information Systems* 4-21.

³ Alturki, A. (2020). Multi-Dimensional Fraud Detection Metrics in Business Processes and their Application. 11:9 *International Journal of Advanced Computer Science and Applications* 5-15.

⁴ Erguden, E. (2020). Analysis of Tourism Companies Listed in Istanbul Stock Exchange According to IFRS-15 Standard. 9:1 *International Journal of Finance & Banking Studies* 47-57.

⁵ Warren, M. (2003). Revenue Recognition and Corporate Counsel. 56 *SMU Law Review*, 56, 885.

⁶ Fisher, W. (2003/2004). Where Were the Counselors? Reflections on Advice Not Given and the Role of Attorneys in the Accounting Crisis. 39 *Gonzaga Law Review* 29.

⁷ Weiss, M. & Berney, E. (2004). Essay: Restoring Investor Trust in Auditing Standards and Accounting Principles. 41 *Harvard Journal on Legislation* 29.

⁸ Whitestone, D. (2005). Note & Comment: The Response to Enron in the United States and Canada: Are Principles-Based Accounting Standards More Effective at Preventing Financial Fraud? 11 *Southwestern Journal of Law and Trade in the Americas* 381.

⁹ Deming, S. (2006). Symposium 2006: The Changing Face of White-Collar Crime: The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act. 96 *Journal of Criminal Law & Criminology* 465.

post-crisis regulatory reforms would be effective in curbing the illegal or unethical behaviour of bankers.¹⁰

Thirteen U.S. legal cases have dealt with the issue of b&h sales. In most of these cases, b&h sales were a tangential issue, not the primary issue. In the Mattel case (1974), the SEC brought suit against a firm for using b&h sales to overstate reported income by \$10.5 million; the SEC issued a declaratory judgment against the firm and ordered them to cease and desist this misleading scheme.¹¹ In the Salzman case (1986), the U.S. Bankruptcy Court in New York City ruled that the debtor company had forged bills of lading for which merchandise had not been shipped; the plaintiff lender had advanced funds to the debtor in reliance upon the validity of the assigned receivables.¹² In the Electro-Catheter case (1987), the SEC filed a suit against the firm for overstating its income by \$1.4 million by improperly reporting or causing to be reported six b&h transactions, representing \$4.5 million in purported revenue, at times when no sales should have been reported under generally accepted accounting principles (GAAP); the court noted that b&h sales are highly unusual in the catheter industry because of the limited shelf life of many products and the resultant need to ship goods as soon after manufacture as possible to the ultimate end-user.¹³ In the Cammer case (1989), the court found a business firm to have overstated its revenue using b&h sales; the court noted that b&h sales are recognizable as revenue only when there is a sound business justification, such as the failure of the customer to instruct the company as to where and when to ship the goods.¹⁴ In the Sunbeam case (1999), a group of stockholders brought suit against several officers and directors of the firm, alleging knowing or reckless conduct that resulted in the overstatement of corporate revenue using b&h transactions; the court dismissed some of the defendants because they were somewhat removed from the day-to-day operations of the corporation, but the other defendants were not dismissed.¹⁵ In the Holmes case (2001), a stockholder brought suit against the corporation, its directors and executives, and its auditor; the plaintiff alleged that b&h transactions had been improperly used to inflate income, but the auditor avoided liability because it had taken preventive measures to stop the accounting fraud.¹⁶ In the Shubert case (2005), a bankruptcy trustee successfully sued a creditor for breach of contract, alleging that the creditor refused to pay for services provided by the debtor; using its power as the larger of the two companies and

¹⁰ Hill, C. (2012). Bankers Behaving Badly? The Limits of Regulatory Reform. 31 *Review of Banking & Financial Law* 675.

¹¹ *SEC v. Mattel, Inc.*, 1974 U.S. Dist. LEXIS 6489 (D.C. 1974).

¹² *In re Salzman*, 61 B.R. 878 (S.D.N.Y. 1986).

¹³ *SEC v. Electro-Catheter Corp.*, 1987 U.S. Dist. LEXIS 1071 (D.C. 1987).

¹⁴ *Cammer v. Bloom*, 1989 U.S. Dist. LEXIS 19284 (N.J. 1989).

¹⁵ *In re Sunbeam Securities Litigation*, 89 F.Supp. 1326 (S.D. Fla. 1999).

¹⁶ *Holmes v. Baker*, 166 F.Supp.2d 1362 (S.D. Fla. 2001).

as the debtor's lender, the creditor coerced the debtor to purchase unneeded products to inflate the creditor's revenues.¹⁷ In the Todd case (2006), the SEC sued the chief executive officer (CEO) and chief financial officer (CFO) of a corporation for securities fraud; one of the claims was that the defendants had issued a false management representation letter to the auditor, but the court held that the change in loan loss reserve was a change in estimate, rather than a change in accounting principle, such that it did not require disclosure.¹⁸ In the Cohen case (2007), the SEC sued a corporate CFO for securities fraud, alleging he accelerated revenue to meet earnings goals which resulted in material misrepresentations in the reporting of corporate income; the CFO obtained money from investors based on the overstated income, falsified books and records, filed misleading reports with the SEC and others, failed to implement internal controls, and made false statements to corporate auditors.¹⁹ In the Bison case (2009), the Chapter 11 bankruptcy debtor was granted authorization to attempt to attain post-petition secured financing; the debtor showed a need for cash to maintain its business relationships and that the financing was essential to its continued viability.²⁰ In the Geswein case (2011), the SEC successfully sued a corporation's former Director of Accounting for securities fraud involving the use of b&h transactions.²¹ In the Doshi case (2015), a group of stockholders sued a corporation for overstating revenue using b&h sales and for failure to prevent theft of inventory resulting in the overstatement of inventory on the balance sheet.²² In the Morning Star case (2020), the U.S. Tax Court found that a corporation's tax return was erroneous because the production costs claimed actually should have been recognized in another tax year; the court also noted that 30% of the corporation's customers had b&h contracts with the firm, but this type of b&h arrangement was acceptable because it was done at the request of and with the permission of the customers.²³ In the Winemaster case (2021), the SEC filed a lawsuit against a business firm, several of its officers and directors, and its auditor for securities fraud; the CEO and other top managers allegedly used b&h sales to overstate the firm's revenue by more than \$30 million. All of the defendants filed motions to dismiss, but the motions were denied and the case is ongoing.²⁴

¹⁷ *Shubert v. Lucent Techs., Inc. (In re Winstar Communs, Inc.)*, 348 B.R. 234 (Del. Bankr. 2005).

¹⁸ *SEC v. Todd*, U.S. Dist. LEXIS 107919 (S.D. Cal. 2006).

¹⁹ *SEC v. Cohen*, 2007 U.S. Dist. LEXIS 28934 (E.D. Mo, E. Div. 2007).

²⁰ *In re Bison Bldg. Materials, LLC*, 2009 Bankr. LEXIS 5077 (S.D. Bankr., Houston Div. 2009).

²¹ *SEC v. Geswein*, 2011 U.S. Dist. LEXIS 111904 (N.D. Ohio, E. Div. 2011).

²² *Doshi v. Gen. Cable Corp.*, 2015 U.S. Dist. LEXIS 9306 (E.D. Ky., N. Div. 2015).

²³ *Morning Star Packing Co., L.P. v. Commissioner*, T.C. Memo 2020-142 (U.S. Tax Ct. 2020).

²⁴ *SEC v. Winemaster*, 2021 U.S. Dist. LEXIS 58750 (N. Dist. Ill., E. Div. 2021), pp. 1-2.

Missing from the literature is a case study of an SEC cease-and-desist proceeding in which corporate officers committed securities fraud by illegally recognizing b&h sales to related parties. This study will fill that gap and will enrich the literature.

III. SPECIFIC OBJECTIVES

The specific objectives of this article are to (a) explain the elements of several types of securities fraud pursuant to the Securities Act of 1933 (Securities Act) and the Securities and Exchange Act of 1934 (Exchange Act), and tell how the corporate officer defendants in this case allegedly violated that statute; (b) explain SEC Rule 10b-5 and tell how the corporate officer defendants in this case allegedly violated Rule 10b-5; (d) explain when a corporation is legally allowed to recognize revenue from a b&h sale, and when such recognition becomes a form of securities fraud; (e) tell whether a corporate officer defendant accused of securities fraud must have accounting expertise in order to be held liable; and (f) state implications for auditors emanating from this case.

IV. RESEARCH METHOD: A CASE STUDY OF MANITEX INTERNATIONAL, INC.

A. Background: The Respondent Company and Its Fraudster Officers

Manitex International, Inc. (Manitex) is a U.S. publicly-traded corporation that manufactures and sells engines. During 2014 and 2015, Manitex was finding it difficult to meet its revenue targets. Despite its extensive marketing efforts, sales remained low because of a lack of demand for its products. This led Manitex to artificially inflate its revenue numbers by fraudulently accounting for several transactions. As a result, Manitex's sales on its income statements during those two years were overstated by more than \$12 million.²⁵

On September 9, 2020, the SEC conducted a cease-and-desist administrative proceeding against Manitex for securities fraud. The proceeding found that several of Manitex's officers had planned and implemented two schemes in violation of federal securities laws. The officers were: Andrew Rooke (Rooke), the Chief Operating Officer; Stephen Harrison (Harrison), the General Manager of Manitex's Crane & Machinery subsidiary; and Michael Schneider (Schneider), the Controller and Chief Financial Officer.²⁶

B. What was the First Fraud Scheme?

In the first scheme, Manitex improperly accounted for and misled its external auditor about its contributions of purported inventory from one of its subsidiaries to Lift Ventures, LLC (Lift

²⁵ Manitex case, Note 2 supra, par. 1-3.

²⁶ Manitex case, Note 2 supra, par. 1.

Ventures), a joint venture created on December 16, 2014. Beginning in January 2014, Rooke and Harrison created false inventory lists and shipping documents which were provided to Manitex's external auditor to cover up a \$1.39 million inventory shortage at one of Manitex's subsidiaries. Later, at Rooke's direction, Manitex purportedly contributed the \$1.39 million in nonexistent inventory to Lift Ventures, a joint venture Rooke and Manitex created with three foreign partners, and it was recorded on Manitex's books as a non-marketable equity investment. As a result, Manitex overstated its 2014 operating income by 11% and pre-tax income by 15%. Manitex continued to list its contribution to Lift Ventures at its full value in its periodic filings with the SEC until September 2016.²⁷

C. What was the Second Fraud Scheme?

In the second scheme, Manitex improperly recognized revenue and misled its external auditor about \$12 million in purported "bill and hold" (b&h) sales of cranes to S.V.W. Crane Equipment Company (SVW). In March 2016, Manitex approached SVW to enter into an agreement to purchase Manitex cranes and rent them to third parties. SVW had no operations, revenue or significant assets, and did not have the financial ability to obtain financing or otherwise pay for or store the cranes purchased from Manitex. At Rooke's direction, Harrison took charge of the SVW relationship, secured the financing for SVW's crane purchases, and, on behalf of Manitex, guaranteed the financing for the cranes. Harrison, in consultation with Rooke, then created a purported financing subsidiary for SVW called Rental Consulting Services Company (RCSC) to conceal the fact that Manitex was making the financing payments. In order to make the payments, Harrison created a series of fraudulent invoices on RCSC letterhead for fictitious services that RCSC purportedly provided to Manitex. Schneider approved the payments despite the fact he knew the RCSC invoices were fake. Manitex should not have recognized revenue on the purported sales. *As a result of the fraud, Manitex overstated its 2016 net revenue by 7% and its 2016 gross profit by 8%. On April 3, 2018, Manitex issued restated financial statements for 2016 and the first two quarters of 2017.*²⁸

D. What Specific Securities Laws Were Violated in this Case?

In the aftermath of the stock market crash of 1929 and the Great Depression which followed, two federal U.S. statutes were enacted pertinent to regulation of the sale of securities (stocks

²⁷ Manitex case, Note 2 supra, par. 2.

²⁸ Manitex case, Note 2 supra, par. 3.

and bonds) on stock exchanges: the Securities Act²⁹ and the Exchange Act.³⁰ The Securities Act regulates initial public offerings of securities. The Exchange Act regulates public offerings of securities following the initial offering, and it also created the Securities and Exchange Commission (SEC), the federal agency charged with enforcement of the Securities Act and the Exchange Act. These two statutes are inapplicable to private corporations, i.e., those corporations whose securities are not traded on a public exchange.

In this case, the SEC, acting in its role of protecting the general public, has issued a cease-and-desist order against Manitex. The SEC stated that three of Manitex's officers (Cooke, Harrison and Schneider) committed securities fraud by violating:

1. Securities Act, s 17(a): This provision makes it unlawful to employ any device, scheme or artifice to defraud, obtain money or property by using material misrepresentations or omissions, or to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser of securities.³¹
2. Exchange Act, s 10(b) and SEC Rule 10b-5: To establish a *prima facie* case, a plaintiff must prove: (a) a material misrepresentation or omission by the defendant; (b) scienter; (c) a connection between the misrepresentation or omission and the purchase or sale of a security; (d) reliance upon the misrepresentation or omission; (e) economic loss; and (f) loss causation.³²
3. Exchange Act, s 13(a) and SEC Rules 12b-20, 13a-1 and 13a-13: Issuers are required to file with the SEC annual reports (Form 10-K) and quarterly reports (Form 10-Q) with audited financial statements and other information and documents which are necessary to keep reasonably current the information and documents required to be filed in the application or registration statement.³³
4. Exchange Act, s 13(b)(2)(A): Issuers are required to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.³⁴

²⁹ Securities Act of 1933 (Securities Act),

https://www.law.cornell.edu/wex/securities_act_of_1933.

³⁰ Securities Exchange Act of 1934 (Exchange Act), https://www.law.cornell.edu/wex/securities_exchange_act_of_1934.

³¹ *SEC v. Milles*, 2022 U.S. Dist. LEXIS 11989 (W.D. Tex., Austin Div. 2022), p. 6.

³² *In re Pareteum Securities Litigation*, 2021 U.S. Dist. LEXIS 151106 (S.D.N.Y. 2021), headnote 7.

³³ *SEC v. Jensen*, 835 F.3d 1100 (9th Cir. 2016), headnote 21.

³⁴ *SEC v. Premier Holding Corp.*, 2021 U.S. Dist. LEXIS 11533 (Central Dist. Calif., So. Div. 2021), p. 4.

5. Exchange Act, s 13(b)(2)(B): Issuers are required to devise and maintain a system of internal accounting controls.³⁵

E. What Is the Significance of SEC Rule 10b-5 In This Case?

SEC Rule 10b-5 broadly prohibits publicly-traded corporations' fraudulent and deceptive practices and untrue statements or omissions of material facts in connection with the purchase or sale of any security. Unlike Section 18 of the Exchange Act, this provision applies to any information released to the public by the issuing corporation, including press releases and annual and quarterly reports to stockholders.³⁶ In this case, SEC Rule 10b-5 was violated when Manitex filed inaccurate financial statements with the SEC.³⁷

F. When Should a Business Firm's Revenue Be Recognized?

According to Generally Accepted Accounting Procedures (GAAP), revenue should be recognized on a company's books when it is realized, realizable and earned. Ordinarily, this is when the transfer of title and risk of loss passes from the seller to the customer—*typically when products are shipped*—provided there is persuasive evidence of an arrangement, the sales price is fixed or determinable and management believes collectability is reasonably assured. However, sometimes non-standard terms or side arrangements relating to a particular sale can affect a seller's ability to recognize revenue while maintaining consistency with GAAP requirements. An excellent example of such a non-standard transaction is a "bill and hold" (b&h) sale.³⁸

G. What is a "Bill and Hold" Sale?

Typically, as noted above, a business firm should book a sale in the accounting records on the shipping date of the goods. However, it is possible for a b&h sale to be an exception to this policy. In a b&h transaction, the sale is recorded in the books *before* the goods are shipped. Ordinarily, GAAP forbids the recognition of revenue emanating from a b&h transaction; this is because the firm is recognizing revenue that has not yet been earned, the sales figure on the income statement will be inflated, and the income will be overstated. All of this will mislead readers of the financial statements. Because of the detrimental effects caused by b&h sales, the law presumes they are an illegal form of securities fraud. However, in exceptional

³⁵ *SEC v. Fraser*, 2010 U.S. Dist. LEXIS 7038 (D. Ariz. 2010), p. 28.

³⁶ *Winemaster* case, Note 25 *supra*, pp. 72-75.

³⁷ *Manitex* case, Note 2 *supra*, par. 45.

³⁸ *Winemaster* case, Note 25 *supra*, p. 7 (*italics added*).

circumstances, b&h sales may be held to be in compliance with GAAP and will be legal. Those exceptional circumstances are covered next.³⁹

H. Pursuant to GAAP, What Exceptional Circumstances Must Be Present In Order For Revenue To Be Properly Recognized From a “Bill and Hold” Sale?

The requirements to be met for proper recognition of revenue from a b&h sale are stringent and strictly applied: (1) the risks of ownership must pass to the buyer at the time of the b&h transaction; (2) the buyer must have made a definite commitment to purchase the goods; (3) the buyer, *not the seller*, must have requested that the transaction be implemented on a b&h basis; (4) the buyer must have a substantial business purpose for placing the order on a b&h basis; (5) the future delivery date of the goods must be fixed and definite; (6) the future delivery date must be reasonable and consistent with the buyer’s substantial business purpose for the b&h transaction; (7) the seller must not retain any specific performance obligations related to the sale; and (8) the goods must be complete and ready for shipment at the time of the b&h transaction.⁴⁰

I. Was Manitex Justified in Recognition of the Revenue From the “Bill and Hold” Sales to SVW?

No. The general rules under GAAP, covered above, mandate that a b&h sale cannot be recognized as revenue if the *seller*, not the buyer, has requested the b&h arrangements. In this case, the seller (Manitex) requested the buyer to accept the b&h arrangements and to agree to an advance recording of the sale on the books before the goods were shipped.⁴¹

J. Why is it Relevant That the Recipient of the Goods in the B&H Sale Was A Related Party?

Ordinarily, GAAP does not allow the recognition of sales to related parties on the income statement. A sale to a related party is tantamount to selling to oneself. Without an arm’s length exchange between two independent parties, there can be no legitimate sale. On a consolidated income statement, for example, intercompany transactions between a parent company and a subsidiary must be eliminated. Auditing Standard 2410 also mandates auditors to scrutinize sales to related parties because they are usually not allowed under GAAP.⁴²

³⁹ Winemaster case, Note 25 supra, pp. 7-8.

⁴⁰ Winemaster case, Note 25 supra, headnote 1 (italics added).

⁴¹ Winemaster case, Note 25 supra, pp. 6-7.

⁴² U.S. Public Company Accounting Oversight Board (PCAOB), (2020). Auditing Standard 2410: Related Parties.

K. Why Are Manitex's Internal Controls, Or Lack Thereof, Significant In This Case?

It is illegal for any publicly-traded firm to knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or accounting required to be kept under s 13(b)(2) of the Exchange Act.⁴³ Accordingly, Manitex had a legal duty to maintain an effective system of internal accounting controls and an effective financial reporting system.⁴⁴

L. Did Rooke, the Chief Operating Officer, Have Responsibilities with Respect to the Financial Statements and the Internal Control System?

Yes. As COO, Rooke was responsible for reviewing and approving Manitex's consolidated financial statements and approving, signing and certifying Manitex's periodic public reports, including SEC 10-K and 10-Q Reports. When he signed each of these Reports, Rooke certified that the attached financial statements did not include any material misstatements or omissions and fairly presented, in all material respects, Manitex's financial condition for the reporting period. Additionally, the COO was responsible for establishing and maintaining Manitex's internal accounting controls.⁴⁵ Rooke committed securities fraud by filing materially misstated financial statements with the SEC for every period from the first quarter of 2014 until his departure from the firm in the fourth quarter of 2016.⁴⁶

M. Did Manitex's Fraudster Managers Try To Conceal Their Fraud Schemes?

Yes. In the first fraud scheme, Rooke and Harrison directed Load King's general manager and controller to override the physical inventory count and add the missing inventory back onto Load King's books and records so that Load King would not have to write off the missing inventory and recognize a loss in earnings. Later, Harrison provided Load King with a list purporting to show the missing inventory and told its managers that the inventory was physically located at Manitex's Crane & Machinery subsidiary in Illinois. This list was also presented to Manitex's external auditor. In reality, the inventory did not exist and should have been written off.⁴⁷

In the second fraud scheme, Harrison created a purported financing subsidiary (RCSC) to pay for SVW's financing obligations. RCSC was controlled by Harrison and Cooke, and SVW's owner was unaware of the RCSC bank account and had no control over RCSC. Harrison

⁴³ Exchange Act, s 13 (b)(2)(B).

⁴⁴ Winemaster case, Note 25 supra, headnote 32 and pp. 92-93.

⁴⁵ Winemaster case, Note 25 supra, pp. 3-4.

⁴⁶ Manitex case, Note 2 supra, par. 1.

⁴⁷ Manitex case, Note 2 supra, par. 14-15.

directed SVW's owner to send him all of the invoices for the SVW crane financing loans. Then, in order to make the financing payments through Crane & Machinery, Harrison created a group of fraudulent invoices on RCSC letterhead primarily for "consulting" that RCSC purportedly provided to Manitex. Actually, none of the RCSC invoices were legitimate; they contained fictitious descriptions for amounts necessary to fund the monthly payments that SVW was required to make to the financing companies for the cranes it purchased from Manitex. Harrison forged the signature of SVW's owner on at least one of the audit confirmations provided to Manitex's external auditor for the 2016 audit.⁴⁸

N. Did Rooke and Schneider Sign False Management Representation Letters and Give Them to Manitex's External Auditor?

Yes. Rooke signed quarterly management representation letters to the external auditor denying any knowledge of fraud during the first three quarters of 2016. Schneider signed management representation letters to the external auditor denying any knowledge of fraud for year-end 2016 and the first two quarters of 2017.⁴⁹

O. How Were the Fraud Schemes Discovered, and What Happened to the Fraudster Managers?

In October 2017, the external auditor began asking questions about the accounting for the crane sales to SVW after discovering a lease agreement that listed Manitex as the debt-holder for some of the cranes. This raised a red flag and Manitex's board of directors hired an external law firm to conduct an investigation. By the end of that investigation, the fraud schemes had become abundantly clear and Manitex's board of directors fired Harrison and Schneider. Rooke had previously left the firm in December 2016.

P. What Was the Total Amount of Inflated Revenue and Profit Revealed by Manitex's Restated Financial Statements?

The 2016 revenue was overstated by \$12 million and the 2016 profit was overstated by \$2.45 million.⁵⁰

Q. Should Manitex's Officers' Bonuses Be Impacted by Manitex's Issuance of a Restatement of Its Financial Statements?

Yes. Pursuant to s 304 of the Sarbanes-Oxley Act, if a publicly-traded company is required to issue an accounting restatement because the firm has violated financial reporting requirements

⁴⁸ Manitex case, Note 2 supra, par. 31, 32, 40.

⁴⁹ Manitex case, Note 2 supra, par. 38-39.

⁵⁰ Manitex case, Note 2 supra, par. 44.

pursuant to the securities fraud laws, corporate officers' bonuses will be disgorged if the bonus was awarded because of corporate performance during the restatement period.⁵¹

R. Are the Three Corporate Officer Defendants Required to Have Accounting Expertise in Order to Be Held Liable For Securities Fraud?

No. They are not required to be accounting experts in order to be held liable for securities fraud. In this case, there is ample evidence that the three defendants were aware that the acts they engaged in were unlawful. For example, Rooke signed and certified each filing despite knowing that revenue had been improperly recognized.⁵²

S. At the SEC Proceeding, Did Manitex Pledge To Improve Its Financial Reporting?

Yes. The firm agreed to continue to review its policies, procedures, controls and training relating to financial reporting, and to implement, if and where appropriate, additional policies, procedures, controls and training. At the end of this review, which in no event could be more than six months after the date of the SEC's order, Manitex was required to submit a report to the SEC staff describing the changes to the firm's policies, procedures, controls and training relating to financial reporting as a result of that review.⁵³

T. At the SEC Proceeding, Did Manitex Pledge To Correct Its Internal Control Deficiencies?

Yes. The material weaknesses in internal control reported in Manitex's 10-K filed on March 10, 2020, were required to be remediated by December 31, 2021. The SEC ordered that if the material weaknesses were not corrected by that date, then an independent consultant would be appointed to conduct a comprehensive review of the outstanding material weaknesses and the financial reporting policies and procedures. At the end of that review, the consultant would be asked to recommend, if and where appropriate, any policies, procedures, controls and training designed to provide reasonable assurance that the firm's internal control over financial reporting is effective.⁵⁴

U. At the End of This Proceeding, Did the SEC Impose a Civil Monetary Penalty Upon Manitex?

Yes. Manitex has assessed a civil monetary penalty in the amount of \$350,000.⁵⁵

⁵¹ Winemaster case, Note 25 supra, headnote 34.

⁵² Winemaster case, Note 25 supra, headnote 24 and pp. 94-95.

⁵³ Manitex case, Note 2 supra, par. 53 (a)-(b).

⁵⁴ Manitex case, Note 2 supra, par. 53(c)-(d).

⁵⁵ Manitex case, Note 2 supra, section IV(C).

V. CONCLUSIONS AND IMPLICATIONS FOR AUDITORS

A. The elements of a securities fraud case pursuant to the Exchange Act are a materially false statement of the defendant contained in a document filed with the SEC; the false statement was relied upon by the plaintiff; and this caused plaintiff's financial loss.

B. SEC Rule 10b-5 requires publicly-traded corporations to be honest and forthright in the information they disseminate to the public. This rule applies not only to statements filed with the SEC but also to press releases and quarterly and annual reports issued to stockholders.

C. Ordinarily, the revenue from a sale of goods should be recognized by the seller when products are shipped. However, sometimes non-standard items or side arrangements relating to a particular sale may be grounds for an exception to this rule. One example of a non-standard transaction is a "bill and hold" (b&h) sale.

D. A b&h sale is recorded on the seller's books before the goods are shipped to the buyer. Ordinarily, the recognition of revenue from a b&h sale is forbidden and is not allowed under GAAP.

E. In rare exceptions, revenue from a b&h sale is allowed if all of the following requirements are met: (1) the risks of ownership must pass to the buyer at the time of the b&h transaction; (2) the buyer must have made a definite commitment to purchase the goods; (3) the buyer, *not the seller*, must have requested that the transaction be implemented on a b&h basis; (4) the buyer must have a substantial business purpose for placing the order on a b&h basis; (5) the future delivery date of the goods must be fixed and definite; (6) the future delivery date must be reasonable and consistent with the buyer's substantial business purpose for the b&h transaction; (7) the seller must not retain any specific performance obligations related to the sale; and (8) the goods must be complete and ready for shipment at the time of the b&h transaction.

F. In the present case, Manitex should not have recognized the revenue from the b&h transactions *because the seller (Manitex) had requested the b&h sale, not the buyer*. Additionally, this revenue should not have been recognized because the sale was to a related party; in other words, the sale was not an arm's length transaction.

G. A publicly-traded company has a legal duty to maintain an effective financial reporting system and an effective system of internal accounting controls. In this case, the Chief Operating Officer certified to the SEC that the financial statements attached to the 10-K and 10-Q Reports

contained no material misstatements; the COO also attested to the effectiveness of the internal control system.

H. The fraudster officers' attempts to conceal the two fraud schemes and their signing of the false management representation letters are evidence of their culpability. They knew the fraud schemes were illegal.

I. After the board of directors launched an investigation, the fraud schemes were discovered. The financial statements for 2016 and the first half of 2017 had to be restarted. The 2016 revenue was overstated by \$12 million and the 2016 income was overstated by \$2.45 million.

J. If a publicly-traded company is compelled to issue a restatement of its financial statements, the company's officers who received a bonus during the restatement period must return it to the company.

K. A corporate officer defendant is not required to be an accounting expert in order to be held liable for securities fraud.

L. At the conclusion of the SEC cease-and-desist proceeding, Manitex was assessed a \$350,000 fine.

M. Implications for auditors emanating from this case include: (1) "bill and hold" sales must be stringently scrutinized, and there should be a presumption of non-recognition unless each and every one of the exceptional circumstances (covered in item E, above) are present; (2) goods that are sold to a related party should also be examined carefully, and ordinarily, the revenue from them should not be recognized because it is not an arm's length transaction; (3) a client's management representation letter should also be parsed, with the auditor looking for untruthful or misleading statements as possible indicators of material misrepresentations or fraud in the financial statements; (4) the auditor should analyze any untruthful or misleading statements made by a client's officers during internal or external investigations because they may also be possible indicators of material misrepresentations or fraud in the financial statements; and (5) if a client is forced to issue a restatement of its financial statements, the client's officers who received a bonus during the restatement period are legally required to return it to the client.
