

# GRADIENT ANALYTICS' RESEARCH PROVIDED EARLY WARNING OF ALLEGED ACCOUNTING FRAUD AT ROYAL A HOLD

## *SEC Complaint Reveals How U.S. Foodservice Executives Fooled Auditors with "False AR Confirmations"*

### **FOR IMMEDIATE RELEASE**

**Scottsdale, AZ (May 16, 2008)** – Gradient Analytics said today its early research into Royal Ahold N.V. published in July 2002 provided early warning on an alleged \$700 million dollar accounting fraud at the company's U.S. Foodservice (USF) subsidiary. According to the SEC complaint in the matter, executives at USF "engaged in a scheme to artificially inflate USF's and Ahold's earnings by hundreds of millions of dollars to meet budgeted earnings targets, and thereby obtain substantial monetary bonuses." The complaint also states that, "USF management perpetuated this scheme to 'book to budget' by, among other things, recording ... (promotional allowances) income that had not been earned."

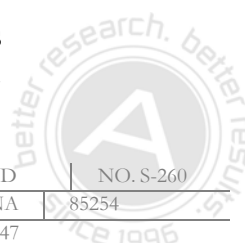
### **External Signs of USF's "Book to Budget" Scheme**

After filing its 2001 20-F with the SEC in mid 2002, Ahold consistently ranked near the top of Gradient's quantitative screens for both unusually high accruals (i.e., non-cash accounting entries) and deteriorating accounts-receivable performance. Based on these quantitative signals and subsequent analyst review, Gradient issued a July 19, 2002, research report that warned clients about the "high level of accruals," "potentially low earnings quality," and a "high likelihood that ... accounts receivable and earnings [were] overstated."

According to the complaint, USF executives "recorded materially overstated (promotional allowances) entries in the books and records of USF." And because there were no cash flows associated with management's bogus promotional allowance entries, AHO's consolidated accounts-receivable balance was materially overstated.

### **Management Misleads Auditors with "False Confirmations"**

Many investors incorrectly believe that because a company's auditors express an "unqualified" opinion on the company's annual report, the financial statements must be presented fairly and in accordance with GAAP. However, several recent SEC complaints show how executives can conceal fraud by making false representations to their auditors.



For example, the SEC complaint against Ahold alleges that executives “induced vendors to confirm falsely inflated (purchase allowances) income and receivable balances to USF’s outside auditors.” As a consequence, the auditors were misled into believing that the fictitious promotional allowances were, in fact, valid.

Commenting on the auditor’s dilemma, Gradient’s editor-in-chief Donn Vickrey said:

“Detecting irregularities in promotional allowances can be particularly difficult. As a newly hired controller for a medical supply company during the mid 1980s, I uncovered a similar overstatement involving promotional allowances. Ultimately I found that the overstatement resulted from an inadvertent ‘double-booking’ of allowances by the previous controller. Were it not for the integrity of management, however, the auditors could easily have been fooled by the improper booking of these allowances.”

### **About Gradient Analytics**

Gradient Analytics is one of the country’s leading independent research firms providing objective, academically rigorous research and quantitative stock ratings for institutional clients.

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