An Inventory Letter from Carter's to Kohl's – What Could Go Wrong?

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Abstract
Mr. Johnson had a highly valued business relationship with Mr. Elles. Johnson was the executive manager of Kohl's Corporation's profitable Children's Division, while Elles served as Carter's, Inc., executive vice-president of sales. All seemed to be going well until Elles asked Johnson to sign a letter that misstated the amount of Kohl's discounts for the prior year's purchases. These two executives had previously negotiated discounts totaling $16.5 million, which Kohl's had already taken. The letter stated the amount as approximately $12.1 million, an understatement of $4.4 million. To Johnson, the signing of the letter apparently seemed like a necessary formality in order to maintain Kohl's favorable discounts. Johnson also desired to keep Kohl's, and particularly its Children's Division, as cost-effective as possible. Kohl's financials would not be affected by the letter. What harm could come from signing the letter?

Learning Outcomes
In completing this assignment, students should be able to:

1. Illustrate the accounting for inventories, including accommodations, by a department store and its supplier using a perpetual inventory system
2. Analyze the impact that recording the accommodations in the wrong accounting period has on the financial statements
3. Evaluate the implications of signing a letter that misrepresents financial information of another company even though one's own company is not impacted
4. Appraise the difficulty of detecting a misstatement when collusion exists and the importance of conducting auditing procedures subsequent to the date of the financial statements

Application
This critical incident is most appropriate for use in an upper-level accounting class, particularly courses such as Intermediate I, Intermediate II, Advanced Accounting, and Auditing. Neither individual mentioned in the case, however, was an accountant. Thus, the case may be suitable for other business classes, such as a principles of accounting, management, marketing, or an MBA class, as this critical incident points out how signing a seemingly innocent, but false, document may have significant ramifications.

Key Words
accommodations, discounts, inventory, letter of representation, perpetual method

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