

# Good example of essay on caterpillar accounting scandal

[Business](#), [Company](#)



## **Introduction**

### Background of Caterpillar

Caterpillar Inc. is an American largest construction equipment company that sold its products in different parts of the world. The company is engaged in " manufacturing construction and mining equipment, industrial gas turbines, diesel and natural gas engines and others" (Baldwin & Rutwitch, 2014). The company owned assets of more than 89 billion dollars. It is the largest company in the overall industry. The company sells its product with a trademark of " Caterpillar Yellow". The company is performing its operations in many countries. The upper management of the company put efforts to acquire other companies and their subsidiaries to increase their business in the market. The goal of the company is to expand the business in different parts of the world.

## **Accounting Fraud**

The company acquired other company Siwei, China in 2013. The price determined for the acquisition was 580 million dollars but Caterpillar paid 800 billion dollars for that company. The action resulted due to the dodging of the acquired company. The management team of the acquired company was fudging to misinterpret the value of the company. The intention was to lead caterpillar overpay the price of the acquisition. Caterpillar was the victim of fraud that was prepared few years back from acquisition (Baldwin & Rutwitch, 2014).

The upper management team of Caterpillar determined that the senior managers of Siwei are involved in misconduct for the last few years before

the acquisition. Caterpillar realized the fraud and misinterpretation of Siwei and started to investigate the problem and recognized two main issues that resulted in the overstated profit. It recognized that the revenue recognition and cost allocation were not properly recorded by the management team. The revenues of the company were overvalued, and the cost was undervalued that resulted in the boost profit of Siwei. The action was related to the fraud and scandal was disclosed by the upper management team of Caterpillar after the acquisition. The company continued investigating and tried to find out the ways for recovering the loss (Boesler, 2013).

## **Role of Caterpillar after Recognizing Fraud**

### Caterpillar Handled the Issue

The company recognized the scandal after the acquisition of the subsidiary. The company decided to recover the loss by enhancing their performance in the operations that was caused due to undervalue of cost and overvalue of revenue recognition. On 18 January 2013 the advocates of the company discovered that the accounting issue was misconduct deliberately by the managers of Siwei (Marget & Peck, 2014). Caterpillar announced that it was trying to resolve the issue with MML parties and improve the operations of the acquired company. Steve Wunning announced that they were not affected by the fraud. They have the support of outstanding dealers, long-term growth strategies and a large base of customers in the Chinese market (Caterpillar Inc., 2013).

## **Steps taken by Caterpillar**

The company announced that it will take 0.87 dollars per share as goodwill. The impairment charge was made on account of recognition of fraud that was committed by Siwei. The reason for the step was to recover the loss occurred to the company for the acquisition of assets at an overstated value. The charge made was equal less than one percent of Caterpillar's market cap. The charge was not helpful for the growth strategy of the company in China. The long-term growth strategy is important for the investment (Baldwin & Rutwitch, 2014).

## **Financial Loss to Caterpillar**

The company suffered loss after discovering the fraud. Caterpillar suffered a loss of 0.5 billion dollars due to the scandal of acquisition committed by Siwei. Caterpillar did not get disappointed; the company was committed to move forward with the new inspiration. Caterpillar impaired for 8.8 billion dollars for autonomy. The loss was less than the danger sign that could raise doubts with regards to doing business in different countries (Montlake, 2013). The financial loss of the company was recovered by itself through effective planning and commitment to regain the situation and cover up the loss in short time.

## **Consequences of the Scandal**

Caterpillar was aware of the consequences that it was likely to face after the discovery of fraud. It had identified the cost of the fraud that was surprising to them. The company had the victim of fraud due to the Electrical Engineering that was acquired in 2012. It was ready to sacrifice their

earnings as the cost of being victimized. The officials of the company suggested to reduce their earnings for at least last quarter of the year 2012 (Montlake, 2013). The adjustments were made to resolve the accounting issues. The company was ready to sacrifice its earning of three months as the reason was to back on the position that was fictitiously created by Siwei's managers (Caterpillar Inc., 2013).

## **Theories for Revenue Recognition**

### True and Fair View

Dumitru & Florin (2008) identified that it is essential for the accountants to prepare financial statements with true and fair view. It is the responsibility of the record keeping accountants to prepare financial statements that is easy to understand by the stakeholders of the company. It should reflect the clear picture of the company's position. The financial statements are audit by the auditors that suggest that it should be clear and fair so to provide true picture to the stakeholders of the company. The auditors (either internal or external) could play significant role in presenting the true and fair view of the company to its owners, customers, investors, creditors and others. The figures of the accounts must not be made on the pretended or future expected changes but it should reflect the present and current values.

In the case of Caterpillar, it could be observed that the values and figures in the financial statements did not represent the true and fair view. The misrepresentation of accounting figures misguided the acquiring company to pay the higher amount from the real value of the company. The case is of fraud because the action was done intentionally by the managers to

overvalue the acquisition amount of the company. The managers were not allowed to break the rule and principles of accounting while recognizing the amount of acquisition (Dumitru & Florin, 2008).

## **Revenue Recognition**

McCarthy & McCarthy (2014) prepared a study to analyze the revenue recognition decisions of more than 127 financial managers. The purpose of the study was to analyze that the managers' decision is in accordance with the accounting based principles. The results of the study showed that there was no significant difference between the revenue recognition of financial managers and accounting rules. It showed that the revenue recognition recorded by the financial managers was logical and easily acceptable by the auditors. The methods and rules for the revenue recognition are set by the accounting rules and regulations, so there is no need to change or contradict with the rules as they are based on the logic and facts.

Caterpillar suffered from the similar issue. The company was misguided by the acquired company that misrepresented the accounts and overvalued revenues that resulted in the boost profit. Caterpillar was not aware of the accounting fraud at the time of acquisition as the action was done before the acquisition. The rules for different types of revenues are set by the accounting authorities that resulted in the common believe of different companies. These rules must be followed by the multinational companies to determine the correct profit figures in the financial statements and reports (McCarthy & McCarthy, 2014).

## **Cost Allocation**

Charaf & Rahmouni (2014) stated that the users of Activity based costing were relying on the performance analysis tool to determine the strengths and weaknesses and to develop new applications. The comparison was made between the two companies. It was found that the company adopted Activity Based Costing (ABC) were more efficient with their cost system. Some of the uses were lack in the system such as budgeting, outsourcing and customer quotes. The research showed that it is essential for the companies to improve their cost system to enhance their performance. The aim of the study was to analyze if there was a need of change in the system or the whole system should not apply ABC for costing. It was found that there was a need of some changes in the system that could effectively allocate the cost. The case of Caterpillar is almost same where the fraud was conducted to increase the value of the company by undervaluing the costs. The system of the cost allocation was missing somewhere and the intended misrepresentation was resulted in (Charaf & Rahmouni, 2014).

## **Efforts of Caterpillar**

The company made various efforts to recover the loss. It has taken some strict measures to avoid such type of things in future. The leaders of the company realized of the fact that the company should take serious actions to avoid fraud in the subsidiary. The senior managers of Siwei were removed from their jobs as they committed the fraud for the previous owners.

Caterpillar gave the responsibility to Caterpillar's China Operations Division. It was decided that the division will directly report to the company's general

manager of Korea and China (Boesler, 2013). The reason for removing the senior managers of Siwei was to avoid such type of misrepresentation in future that had put a question mark on Caterpillar.

The shareholders and other stakeholders of the company were disappointed with the fraud and it was difficult for the company to regain the trust of the stakeholders. The company took some steps to change the management of the acquired company and to ensure the effectiveness of performance of the employees. The upper management of the company was making efforts to resolve the issue by increasing their operational activities in the country (Boesler, 2013).

## **Conclusion**

The paper contains the fraud that was committed to boost up the value of the acquired company and to misinterpret the acquiring company that has good reputation in the market. In the case Caterpillar was not aware of the fraud that was planned prior to the acquisition. Besides the criminal offence the senior managers of Siwei misguide Caterpillar. Caterpillar had to resolve the issue as the deal was finalized, and the contract was made on the agreed price pretended by the managers of Siwei.

The steps and measures taken by Caterpillar were effective as it retains others to continue the fraudulent behavior in the acquired organization. The decision was to recover the loss by increasing the performance of the employees of the company and regain the position in the market. Caterpillar did not give up from the situation and put strong efforts to recover the loss with increasing performance of the company as a whole. The company



continued doing business in China to retain the position in the competitive market.

Caterpillar inspiration and commitment supported the evidence that the company should handle the situation in an effective manner and appoint a team of auditor to ensure that financial statements of the acquired company are in accordance with the rules and policies of accounting. Caterpillar set an example for the multinational companies to follow rational behavior and clearly check the worth of the business before purchasing it. The methods mentioned in the rule book of accounts are helpful in analyzing the fair and market value of assets, liabilities and equities that are followed by the multinational companies. The standards followed in the country of acquired company must be followed by them. The requirement is to investigate properly the value of the acquired company. Acquisition decision could be effective through extensive research and auditing. The decision must be taken after analyzing market value of assets of the company.

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