April is the cruelest month.

T. S. Eliot

In April 1979 James Cunningham, H. J. Heinz Company’s president and chief operating officer, learned that since 1972 certain Heinz divisions had allegedly engaged in improper income transferal practices. Payments had been made to certain vendors in a particular fiscal year, then repaid or exchanged for services in the succeeding fiscal year.¹

These allegations came out during the investigation of an unrelated antitrust matter. Apparent improprieties were discovered in the records of the Heinz USA division’s relationship with one of its advertising agencies. Joseph Stangerson—senior vice president, secretary, and general counsel for Heinz—asked the advertising agency about the alleged practices. Not only had the agency personnel confirmed the allegation about Heinz USA, it indicated that similar practices had been used by Star-Kist Foods, another Heinz division. The divisions allegedly solicited improper invoices from the advertising agency in fiscal year (FY) 1974 so that they could transfer income to FY 1975. While the invoices were paid in FY 1974, the services described on the invoices were not rendered until some time during FY 1975. Rather than capitalizing the amount as a prepaid expense, the amount was charged as an expense in FY 1974. The result was an understatement of FY 1974 income and an equivalent overstatement of FY 1975 income.

Stangerson reported the problem to John Bailey, vice chairman and chief executive officer; to Robert Kelly, senior vice president—finance and treasurer; and to Cunningham. Bailey, CEO since 1966, had presided over 13 uninterrupted years of earnings growth. He

was scheduled to retire as vice chairman and CEO on July 1 and would remain as a member of the board of directors. James Cunningham, who had been president and chief operating officer since 1972, was to become chief executive officer on July 1, 1979.

Subsequent reports indicate that neither the scope of the practice nor the amounts involved were known. There was no apparent reason to believe that the amounts involved would have had a material effect on Heinz's reported earnings during the time period, including earnings for FY 1979 ending May 2. (Heinz reported financial results on the basis of a 52–53 week fiscal year ending on the Wednesday closest to April 30.) Stangerson was not prepared to say whether the alleged practices were legal or illegal. "This thing could be something terrible or it could be merely a department head using conservative accounting practices; we don't know," one Heinz senior official stated to the press.

**Background**

Henry J. Heinz, on founding the company in 1869 in Pittsburgh, Pennsylvania, said: "This is my goal—to bring home-cooking standards into canned foods, making them so altogether wholesome and delicious and at the same time so reasonable that people everywhere will enjoy them in abundance." The company's involvement in food products never changed, and in 1979 Heinz operated some 30 companies with products reaching 150 countries. Heinz reported sales of over $2.2 billion and net income of $99.1 million in FY 1978.

After a sluggish period in the early 1960s, a reorganization was undertaken to position Heinz for growth. Under the guidance of John Bailey and James Cunningham, Heinz prospered through a major recession, government price controls, and major currency fluctuations. The 1978 annual report reflected management's pride in Heinz's remarkably consistent growth:

Fiscal 1978 went into the books as the fifteenth consecutive year of record results for Heinz. Earnings rose to another new high. Sales reached more than $2 billion only six years after we had passed the $1 billion mark for the first time in our century-long history. We are determined to maintain the financial integrity of our enterprise and support its future growth toward ever-higher levels. [Exhibit 1 presents a financial summary of fiscal years 1972–1978.]

Although Heinz was a multinational firm, domestic operations accounted for 62% of sales and 67% of earnings in FY 1978. Five major divisions operated in the United States in 1979.

Throughout the 1970s Heinz's major objective was consistent growth in earnings. While Heinz management did not consider acquisitions to be crucial to continuing growth, it looked favorably on purchase opportunities in areas where Heinz had demonstrated capabilities. Bailey and Cunningham stressed profit increases through the elimination of marginally profitable products. Increased advertising of successful traditional products and new product development efforts also contributed to Heinz's growth. Heinz's commitment to decentralized authority as an organizational principle aided the management of internal growth as well as acquisitions.

**Organization**

In 1979 Heinz was organized on two primary levels. The corporate world headquarters, located in Pittsburgh, consisted of the principal corporate officers and historically small staffs (management described the world headquarters as lean). World headquarters had the responsibility for "the decentralized coordination and control needed to set overall standards and ensure performance in accordance with them." Some Heinz operating divisions reported directly to the president; others reported through senior vice presidents who were designated area directors (see Exhibit 2). World headquarters officers worked with division senior managers in areas such as planning, product and market development, and capital programs.

Heinz's divisions were largely autonomous operating companies. Division managers were directly responsible for the division's products and services, and they operated their own research and development, manufacturing, and marketing facilities. Division staff reported directly to division managers and had neither formal reporting nor dotted-line relationships with corporate staff.

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World headquarters officers monitored division performance through conventional business budgets and financial reports. If reported performance was in line with corporate financial goals, little inquiry into the details of division operation was made. On the other hand, variations from planned performance drew a great deal of attention from world headquarters; then, divisions were pressured to improve results. A review was held near the end of the third fiscal quarter to discuss expected year-end results. If shortfalls were apparent, other divisions were often encouraged to improve their performance. The aim was to meet projected consolidated earnings and goals. Predictability was a watchword and surprises were to be avoided. A consistent growth in earnings attended this management philosophy.

Management Incentive Plan

Designed by a prominent management consulting firm, the management incentive plan (MIP) was regarded as a prime management tool used to achieve corporate goals. MIP comprised roughly 225 employees, including corporate officers, senior world headquarters personnel, and senior personnel of most divisions. Incentive compensation was awarded on the basis of an earned number of MIP points and in some cases reached 40% of total compensation.

MIP points could be earned through the achievement of personal goals. These goals were established at the beginning of each fiscal year in consultation with the participant's immediate supervisor. Points were awarded by the supervisor at the end of the year, based on goal achievement. In practice, personal goal point awards fell out on a curve, with few individuals receiving very high or very low awards.

MIP points were also awarded based on net profit after tax (NPAT) goals. Corporate NPAT goals were set at the beginning of the fiscal year by the management development and compensation committee (MDC) of the board of directors. The chief executive officer, the chief operating officer, the senior vice president–finance, and the senior vice president–corporate development then set MIP goals for each division, with the aggregate of division goals usually exceeding the corporate goal. Two goals were set—a fair goal, which was consistently higher than the preceding year's NPAT, and a higher outstanding goal. The full number of MIP points was earned by achieving the outstanding goal.

Senior corporate managers were responsible for executing the system. While divisional input was not uncommon, division NPAT goals were set unilaterally and did not necessarily reflect a division's budgeted profits. Once set, goals were seldom changed during the year. The officers who set the goals awarded MIP points at the end of the fiscal year. No points were awarded to personnel in a division that failed to achieve its fair goal, and points were weighted to favor results at or near the outstanding goal. One or more bonus points might be awarded if the outstanding goal was exceeded. Corporate officers also had the authority to make adjustments or award arbitrary points in special circumstances. The basis for these adjustments was not discussed with division personnel.

MIP points for consolidated corporate performance were awarded by the MDC committee of the board. Corporate points were credited to all MIP participants except those in a division that did not achieve its fair goal. The MDC committee could also award company bonus points.

Heinz also had a long-term incentive plan based on a revolving three-year cycle. Participation was limited to senior corporate management and division presidents or managing directors for a total of 19 persons.

Corporate Ethical Policy

Heinz had an explicit corporate ethical policy that was adopted in May 1976. Among other things, it stated that no division should:

1. have any form of unrecorded assets or false entries on its books or records;
2. make or approve any payment with the intention or understanding that any part of such payment was to be used for any purpose other than that described by the documents supporting the payment;
3. make political contributions;

4. make payments or gifts to public officials or customers; or
5. accept gifts or payments of more than a nominal amount.

Each year the president or managing director and the chief financial officer of each division were required to sign a representation letter which, among other things, confirmed compliance with the corporate Code of Ethics.

April 1979

Heinz itself had originated the antitrust proceedings that led to the discovery of the alleged practices. In 1976 Heinz filed a private antitrust suit against the Campbell Soup Company, accusing Campbell of monopolistic practices in the canned soup market. Campbell promptly countersued, charging that Heinz monopolized the ketchup market.8 Campbell attorneys, preparing for court action, subpoenaed Heinz documents reflecting its financial relationships with one of its advertising agencies. In April 1979, while taking a deposition from Arthur West, president of the Heinz USA division, Campbell attorneys asked about flows of funds, "certain items which can be called off-book accounts." West refused to answer, claiming Fifth Amendment protection from self-incrimination.9 Stangerson then spoke with the advertising agency and received confirmation of the invoicing practices.

### Summary of Operations

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales ($ thousands)</th>
<th>Cost of products sold ($ thousands)</th>
<th>Interest expense ($ thousands)</th>
<th>Provision for income taxes ($ thousands)</th>
<th>Income from continuing operations ($ thousands)</th>
<th>Loss from discontinued and expropriated operations ($ thousands)</th>
<th>Income before extraordinary items ($ thousands)</th>
<th>Extraordinary items ($ thousands)</th>
<th>Net income ($ thousands)</th>
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<td>1978</td>
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### Per Common Share Amounts

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<tr>
<th>Year</th>
<th>Income from continuing operations ($ per share)</th>
<th>Loss from discontinued and expropriated operations ($ per share)</th>
<th>Income before extraordinary items ($ per share)</th>
<th>Extraordinary items ($ per share)</th>
<th>Net income ($ per share)</th>
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### Other Data

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<th>Data Category</th>
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<tr>
<td>Common, per share</td>
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<td>Preferred, total</td>
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<td>Capital expenditures</td>
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<td>Depreciation</td>
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<td>Shareholders’ equity</td>
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<td>Average number of common shares outstanding</td>
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<td>Book value per common share</td>
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<td>Price range of common stock</td>
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<tr>
<td>Sales (%)</td>
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<tr>
<td>Foreign</td>
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<tr>
<td>Income (%)</td>
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<td>67</td>
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<tr>
<td>Foreign</td>
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</table>

Source: Company records
Exhibit 2
Organization Chart, April 1979

Board of Directors

Chairman
Henry J. Heinz, IIa

Vice Chairman and
Chief Executive Officer
John Baileyb

Chief Operating Officer
James Cunninghamb

Senior VP;
Chairman,
Star-Kist Foodsa
Area Director

Senior VP
Corporate Developmenta

Senior VP
Finance and
Treasurer
Robert Kellya

Senior VP
Secretary and
General Counsel
Joseph Stangersona

Senior VP
Area Directora

Senior VP
Area Directora

Star-Kist Foods
Operations in
Japan (1963)b

President
Heinz USA
Arthur West

The Hubinger
Company (1975)b

Ore-Ida
Foods (1965)b

Chairman and CEO
Weight Watchers
Internationala
(1978)b

Operations
in Australia,
Canada, and Latin
America

Operations in
the United
Kingdom,
Italy,
Portugal, and
Continental
Europe

a. Member of the board of directors
b. Date in parenthesis indicates year acquired