

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 9132 / August 5, 2010**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 62653 / August 5, 2010**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3165 / August 5, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13994**

**In the Matter of**

**NAVISTAR INTERNATIONAL  
CORPORATION,  
DANIEL C. USTIAN,  
ROBERT C. LANNERT,  
THOMAS M. AKERS, JR.,  
JAMES W. MCINTOSH,  
JAMES J. STANAWAY,  
ERNEST A. STINSA,  
MICHAEL J. SCHULTZ,**

**Respondents.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTION 8A OF THE SECURITIES  
ACT OF 1933 AND SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934, MAKING FINDINGS, AND IMPOSING  
A CEASE-AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Navistar International Corporation (“Navistar” or the “Company”), Daniel C. Ustian, Robert C. Lannert, Thomas M. Akers, Jr., James W. McIntosh, James J. Stanaway, Ernest A. Stinsa, and Michael J. Schultz (collectively “Respondents”) pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”).

## II.

In anticipation of the institution of these proceedings, Respondents have each submitted Offers of Settlement (the “Offers”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings or conclusions contained herein, except as to the Commission’s jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

## III.

On the basis of this Order and Respondents’ Offers, the Commission finds<sup>1</sup> that:

### A. SUMMARY

1. This is a financial fraud, reporting, and internal controls case against Navistar, a Fortune 200 manufacturer of commercial trucks and engines, and certain current and former employees. At times from 2001 through 2005, Navistar overstated its pre-tax income by a total of approximately \$137 million as the result of various instances of misconduct. Fraud at a Wisconsin foundry and in connection with certain vendor rebates and vendor tooling transactions accounted for approximately \$58 million of that total. The remaining approximately \$79 million resulted from improper accounting for certain warranty reserves and deferred expenses. These findings do not reflect a coordinated scheme by senior management to manipulate the Company’s reported results or conduct committed with the intent of personal gain. Instead, these findings reflect misconduct that resulted in large part from a deficient system of internal controls, evidenced in part by insufficient numbers of employees with accounting training, a lack of written accounting policies and procedures, and flaws in the Company’s organizational structure. The internal control deficiencies, in turn, resulted from senior management’s failure to dedicate sufficient resources and attention to the adequacy of Navistar’s accounting and reporting functions. The deficient internal controls failed to provide adequate checks on certain employees’ efforts to meet the Company’s financial targets.

### B. RESPONDENTS

2. Navistar, a Delaware corporation headquartered in Warrenville, Illinois, is a holding company whose principal subsidiary, Navistar, Inc. (f/k/a International Truck and Engine Corporation), manufactures and markets commercial trucks, school buses, diesel engines, and related parts worldwide. During the relevant period, Navistar’s securities were registered with the

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<sup>1</sup> The findings herein are made pursuant to Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. As of November 30, 2009, Navistar had 70,718,762 shares outstanding.

3. Daniel C. Ustian (“Ustian”), 60, of Naperville, Illinois, is Chairman, Chief Executive Officer (“CEO”) and President of Navistar. Ustian held various titles at the Company during the relevant period. From 1999 through April 2002, Ustian was President of the Engine Division. In April 2002, Ustian was promoted to President and Chief Operating Officer of Navistar. In February 2003, Ustian also became Navistar’s CEO. In February 2004, Ustian was elected Board Chairman.

4. Robert C. Lannert (“Lannert”), 70, of Burr Ridge, Illinois, was the Company’s Vice Chairman and Chief Financial Officer (“CFO”) throughout the relevant period. Lannert had direct responsibility for Navistar’s accounting department and the Corporate Controller’s Office, and was ultimately responsible for the Company’s internal controls. Lannert was terminated by Navistar in October 2007.

5. Thomas M. Akers, Jr. (“Akers”), 58, of Aurora, Illinois, was Director of Purchasing for the Engine Division from April 1996 through August 2004. He was thereafter promoted to Vice President, Purchasing and Logistics and remained in that position until his retirement in January 2009.

6. James W. McIntosh (“McIntosh”), 60, of Naperville, Illinois, was Vice President of Finance for the Engine Division throughout the relevant period. In that position, McIntosh was the CFO of the Engine Division and was directly responsible for its accounting, financial reporting, and internal controls. McIntosh was transferred to the Parts Group in January 2006 and subsequently retired in May 2007.

7. James J. Stanaway (“Stanaway”), 64, of Springfield, Ohio, was Director of Finance for the Engine Division during the relevant period through June 2004, when he retired from the Company. In that role, Stanaway reported directly to McIntosh.

8. Ernest A. Stinsa (“Stinsa”), 41, of Elmhurst, Illinois, replaced Stanaway as Director of Finance for the Engine Division in 2004. Stinsa left Navistar in January 2006, but rejoined the Company in May 2010 in its Global Product Development division. In his new capacity, Stinsa has no direct accounting or financial reporting responsibilities.

9. Michael J. Schultz (“Schultz”), 45, of Waukegan, Illinois, was the Plant Controller at Navistar’s foundry in Waukesha, Wisconsin, during the relevant period. Schultz was terminated in April 2005.

## C. FACTUAL FINDINGS AND CONCLUSIONS

### 1. Background

#### a) Navistar's Restatement

10. In December 2007, the Company filed a delayed Form 10-K for fiscal 2005 that included a restatement of its financial statements for fiscal years 2002-2004 and the first three quarters of fiscal year 2005 ("Restatement Period").<sup>2</sup> For the year ended October 31, 2004, Navistar restated its previously-reported pre-tax profit of \$311 million to a pre-tax loss of \$35 million. For the year ended October 31, 2003, the previously-reported pre-tax loss of \$49 million was restated to a pre-tax loss of \$316 million. The previously-reported accumulated deficit as of November 1, 2002 of \$731 million was restated to an accumulated deficit of \$2.4 billion. In all, Navistar restated or reclassified sixteen different items. The restatement was comprised of widely varying accounting errors, related to different individuals working at different Company locations, and occurred during years of profit and years of loss.

11. The restatement was required because Navistar's previously reported financial statements as filed in its annual reports in Forms 10-K and its quarterly reports in Forms 10-Q for the Restatement Period materially failed to comply with Generally Accepted Accounting Principles ("GAAP") and the financial reporting requirements under the securities laws.

#### b) Ustian's and Lannert's Bonuses During the Restatement Period

12. During the 12-month period following Navistar's filing of its Form 10-K for fiscal year 2004 (later restated), and based on the Company's originally-reported financial results for that fiscal year, Ustian and Lannert received performance-based bonuses totaling \$2 million and \$1,049,503 (an original grant of \$828,555, later corrected by an additional payment of \$220,948) respectively. Ustian and Lannert have not reimbursed Navistar for any portion of the bonuses they received.

### 2. Internal Control Deficiencies

13. Navistar had numerous deficiencies throughout its system of internal controls during the relevant period, including fifteen material weaknesses,<sup>3</sup> that were attributable, in part, to

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<sup>2</sup> In April 2006, the Company announced that its previously issued financial statements for fiscal years ended October 31, 2002 through October 31, 2004 and its previously issued quarterly financial statements for periods after October 31, 2004 should be restated. In its December 2007 filing, the Company restated its income (loss) before income tax for fiscal years 2003 and 2004 and for the first three quarters of fiscal year 2005 to reflect various adjustments, including certain matters discussed herein. With respect to fiscal year 2002, the Company adjusted its accumulated deficit as of November 1, 2002, to reflect corrected items that related to prior periods. The Company did not separately restate its income (loss) for fiscal year 2002.

<sup>3</sup> In its Form 10-K for fiscal year 2005 (filed in December 2007), Navistar disclosed fifteen separate material weaknesses in its internal controls for 2005-06.

the Company's failure to dedicate sufficient resources to those controls. For example, requests by managers to hire additional employees with accounting backgrounds and to assign additional employees to the Company's accounting policies and procedures function were denied because of budgetary concerns; during 2000-2001 there was only one full-time employee dedicated to the policies and procedures function. The Company's failure to address the internal control deficiencies contributed to at least some of the misconduct described below.

14. Ustian, Lannert, and McIntosh each was responsible for certain aspects of the Company's internal controls. Each failed to take certain steps that would have ensured the Company established and maintained adequate internal controls in certain respects, and their failure to act was a cause of certain of the Company's internal control deficiencies. Each knew or should have known that the failure to act would contribute to weaknesses in those controls.

15. For example, in 2002, the Company's Internal Audit department warned senior management that Navistar's accounting policies and procedures needed to be updated. Although Lannert oversaw a plan to address Internal Audit's concerns, the policies and procedures were not updated at that time because of other perceived priorities. Additionally, McIntosh failed to increase the number of Engine Division employees competently trained in GAAP despite being told that additional employees with such capabilities were needed. Deficient accounting policies and procedures and an inadequate number of employees trained in accounting were among the material weaknesses disclosed by the Company in its Form 10-K for fiscal year 2005.

16. In another instance, Lannert and the Corporate Controller's Office proposed a change to Navistar's corporate organizational structure so that finance personnel in the Engine and the Truck divisions, who were then reporting to the division operations managers, would instead report directly to the CFO or the Corporate Controller's Office. Lannert and the Corporate Controller's Office thought that this change would allow divisional finance personnel to voice more freely any concerns or questions regarding accounting issues without fear of reprisal and provide support for divisional finance personnel in addressing the demands of the operational managers. Ustian decided to maintain the established reporting structure, believing it allowed finance personnel to understand more fully the nature of the underlying business. The Company took no other steps to address the underlying concerns that prompted the proposal to change the organizational structure. This structure contributed to the misconduct in recording vendor rebates (described below), in which an Engine Division purchasing finance employee booked certain questionable transactions because of feared reprisal from an Engine Division operations manager. As part of the remedial steps taken in connection with its restatement, Navistar changed this structure so that divisional finance personnel now report directly to the CFO.

### 3. Improper Accounting Practices at Navistar

#### a) Vendor Rebates and Vendor Tooling

##### i) Vendor Rebates

17. During the 2001 to 2004 time period, Navistar ramped up its engine production beyond initial expectations and correspondingly increased its purchases of engine parts from suppliers. Navistar sought to share in those suppliers' unanticipated profits by asking them to pay a portion back to the Company in the form of rebates. Under GAAP, a company could recognize rebates only when they were actually earned, *i.e.*, when the entity had substantially accomplished what was necessary to be entitled to such rebates. Accordingly, Navistar could record the full rebate as income in the then-current period *only* if no contingencies existed on its right to receive the rebate. Conversely, the Company was prohibited from booking rebates as income in the then-current period if they were based on future business.

18. During this period, Navistar booked 35 rebates and related receivables from its suppliers. Of those rebates and receivables, as many as 30 were improperly booked. While these rebates and receivables took different forms -- including volume-based rebates and so-called "signing bonuses" for Navistar's award of new business -- all were improperly booked as income in their entirety upfront, even though, in whole or in part, they were earned in future periods. The Company's eventual restatement of these rebates and receivables totaled \$9.7 million of pre-tax income in 2004 and \$8.5 million in 2003, which represented 27.7 percent and 2.7 percent, respectively, of the restated loss before income taxes for those years.

19. The vast majority of these receivables were volume-based rebates that Navistar obtained from its suppliers at the end (or even after the end) of the fiscal year. As contingent consideration for paying these rebates, however, many suppliers required the Company either to agree to new business or to repay the amount of the rebate in the form of waived price concessions on already-agreed upon future business. The Engine Division booked these rebates, often using the same form letter (which in certain instances was back-dated) that falsely stated that the rebate was based on past purchases and had no contingencies. In some instances, certain Engine Division employees also generated side-letter arrangements with vendors that detailed that the rebates were contingent on future purchases and/or the vendor could recoup the rebate through inflated future prices by which the Company would forego agreed-upon price reductions. Additionally, these side-letters stated that Navistar would refund the rebate accordingly if the Company failed to make sufficient future purchases. These side-letters made clear that these rebates had not actually been earned at the time the amounts were recognized.

20. In one instance, "Vendor Rebate 1," a supplier executed a form rebate letter drafted by Navistar, and dated October 19, 2004, that said the supplier was providing the Company a \$2.1 million rebate based on "2004 volume and piece price productivity improvements." However, the very next day, October 20, 2004, the parties executed a side-letter arrangement that specifically stated that half of the rebate was based on pulling forward productivity improvements expected to be achieved in 2005. Navistar also agreed to refund any shortfall to the supplier should these

improvements not be achieved. Thus, the side-letter made clear that the supplier's rebate was contingent on future business with the Company. Nevertheless, Navistar approved the rebate and booked the entire dollar amount in fiscal year 2004.

21. Another form of these improperly-booked rebates were so-called "signing bonuses" that Navistar demanded and received from certain suppliers in exchange for awarding new business. Despite the fact that the suppliers' payments were contingent on receiving that new business from Navistar, the Company booked the rebates in their entirety during the then-current period in which they were received, instead of when earned over the period of the future business.

22. In one such instance, "Vendor Rebate 2," McIntosh contacted Stanaway four days after the 2003 fiscal year-end to discuss the need to fill an earnings shortfall. Stanaway, in turn, discussed the shortfall with Akers, who in exchange for promising to provide future business to a particular supplier in 2004, convinced the supplier to agree to pay a \$6.2 million signing bonus to the Company and to provide Navistar with a letter that would allow the Company to book the full amount in 2003. The vendor had never before done business with Navistar. Akers had engaged in previous discussions with the vendor about possible future business and the payment of a signing bonus, but the terms of the signing bonus were not finalized until after the 2003 fiscal year-end. Stanaway, who had no direct role in acquiring the rebate, then approved an entry recording the \$6.2 million as income in 2003.

23. McIntosh, Akers, and Stanaway understood that to be booked in the current period, such rebates could not be contingent or otherwise based on future business. Despite this understanding, McIntosh and Akers directly negotiated or otherwise arranged for the Company to enter into and book certain rebates during the then-current period knowing, or recklessly failing to know, that such rebates were contingent on future business. As recorded, these rebates were not in compliance with GAAP. Additionally, McIntosh and Akers directly or indirectly approved the creation and use of letters that they knew or recklessly failed to know did not reflect material aspects of the transaction.

24. Akers initiated the concept at Navistar of seeking vendor rebates based on volume increases and often supervised the employees negotiating the vendor rebates and related receivables. In several instances, including Vendor Rebate 1 and Vendor Rebate 2, Akers directly or indirectly approved rebates that he knew, or recklessly failed to know, were tied to future business but would nonetheless be booked in the then-current period. Akers participated directly in the negotiations of multiple rebates and, in certain instances, personally received both a "clean letter" and "side-letter" for the same rebate, which was evidence that the rebate had contingencies.

25. As CFO of the Engine Division, McIntosh was responsible for the accounting for all Engine receivables during the relevant period, including all vendor rebates. McIntosh was involved in the planning of at least three rebates, including Vendor Rebate 2, knowing, or recklessly failing to know, that they were contingent on future business but would nonetheless be booked in their entirety in the then-current period.

26. As Director of Engine Finance, Stanaway approved the recording of receivables from fiscal 2001 through 2003, including all vendor rebates. Stanaway typically was not involved in the negotiation of vendor rebate agreements or the procuring of “clean” letters that supported the booking of such rebates, and usually became involved in these transactions only at the final approval stage. Despite his lack of involvement in obtaining these vendor rebates, Stanaway approved the booking of certain rebates as income, including the booking of Vendor Rebate 2, knowing, or recklessly failing to know, that they were contingent on future business and should not be booked as income in the current period. Stanaway had little accounting background or formal training in GAAP at the time of the transactions.

27. Stinsa succeeded Stanaway for a relatively brief period, from July 2004 until January 2006. As Stanaway’s successor, Stinsa was not involved in the negotiation of vendor rebate agreements or the procuring of “clean” letters that supported the booking of such rebates. Instead, Stinsa became involved in the vendor rebate process only when asked on a sporadic basis to approve booking certain rebates. While authorized to approve booking these receivables, Stinsa’s primary responsibilities did not include these transactions, and he had little accounting background or formal training in GAAP at the time of the transactions. For example, Stinsa did not specifically know whether booking so-called “signing bonuses” into income in the then-current period was consistent with GAAP; instead, he assumed it was, because he knew the Company had a practice of soliciting and booking such receivables. In fiscal 2004, Stinsa erroneously approved the booking of a \$4 million signing bonus based on a letter that, while expressly stating that the bonus was unconditional, also stated that the payment concerned the award of “new” business. Stinsa should have inquired whether the receivable was, in fact, contingent on the vendor’s expected new business with Navistar. Stinsa erroneously approved the booking of two other vendor rebates in fiscal 2004, including another signing bonus and a volume-based rebate. In approving these rebates without sufficient inquiry, Stinsa directly or indirectly caused Navistar to enter a false financial book, record or account.

ii) Vendor Tooling

28. Prior to 2003, Navistar periodically entered into amortization agreements concerning the cost of tooling with vendors. Under these arrangements, the vendors purchased the tooling they used to make parts sold to Navistar, and the Company repaid the suppliers for those tooling costs through amortization payments incorporated in the piece-price rates of the parts ultimately sold to Navistar. In 2003, the Company determined that in some instances, instead of continuing these amortization payments, the Company would benefit (in part through beneficial accounting treatment) by purchasing the tooling outright from the suppliers and depreciating the tooling costs going forward over a longer period. Consequently, in 2003, the Company initiated a program pursuant to which Navistar arranged to terminate certain of these amortization agreements and acquired the tooling via lump sum payments to the suppliers. However, instead of paying suppliers the remaining unamortized tooling cost as of the 2003 purchase date, the Company paid the suppliers a dollar amount equivalent to the unamortized tooling cost as of the beginning of the 2003 fiscal year. Since Navistar had already been paying amortization to the suppliers since the start of that fiscal year (*i.e.*, November 1, 2002), the Company arranged to receive back from those suppliers a “rebate” equivalent to those year-to-date amortization payments. The Company then



improperly booked these rebates into income. In addition, the Company improperly deferred depreciation costs related to the tooling buybacks.<sup>4</sup>

29. In 2003, two Navistar employees approached the Company's outside auditor regarding the accounting for certain contemplated tooling buyback transactions. After learning of the planned accounting for the program, e-mails indicate that the auditor informed the employees that the recapture and booking of previously-paid amortization into income was improper. While certain transactions were booked in fiscal year 2003 because they were believed to be of immaterial dollar amounts, e-mails indicate that the auditor informed the Company that no such transactions would be permitted in fiscal year 2004. Despite being informed of these developments, McIntosh used a "60-day rule" and authorized Engine Division employees in 2004 to record 60 days of amortization recaptured as income based on the Company's payment terms. In so doing, McIntosh disregarded employees' warnings that continuing to record the recapture of amortization as income would be inconsistent with the auditor's guidance on the accounting.

30. In disregarding that guidance, McIntosh knew or recklessly failed to know that Navistar booked income in violation of GAAP. In 2004, the Company restated a total of \$1.6 million in income related to the vendor tooling buyback program, or 4.6 percent of the restated loss before income taxes for that year.<sup>5</sup>

**b) Waukesha**

31. From 2001 to 2005, Schultz, the Waukesha plant controller, engaged in various fraudulent accounting practices that collectively caused income during that period to be overstated by a total of approximately \$38 million. Specifically, Schultz's conduct included the following:

Accounts Payable. From early 2003 through 2005, Schultz directed the plant manager of accounting to delay processing certain vendor invoices that had been received and to refrain from accruing those unprocessed invoices in accounts payable as current period expenses in order to help reach certain plant financial goals.

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<sup>4</sup> The following hypothetical example illustrates how the program worked. As of November 1, 2002, Navistar has a balance due on tooling to a supplier of \$3 million. From November 1, 2002 through May 31, 2003, Navistar pays \$1 million in amortization for the tooling. On May 31, 2003, Navistar decides to purchase the tooling outright, stop paying and recording amortization expenses, and begin recording depreciation. At the May 31 sale date, based on its amortization payments to date, Navistar's outstanding obligation to the supplier is \$2 million. But instead of paying the supplier \$2 million for the tooling, Navistar pays the supplier the tooling's balance due as of November 1, 2002, *i.e.*, \$3 million. Since Navistar had already paid \$1 million in amortization for the tooling from November 1, 2002, Navistar requires the supplier to simultaneously pay the Company a rebate of \$1 million, *i.e.*, the previously-paid amortization. The Company then incorrectly records the \$1 million rebate as a reduction in the cost of goods sold, increasing income for the May 2003 quarter. Instead, the Company should have either only paid the remaining balance due on the tooling at the time of purchase without booking a rebate to income or it should have netted the two transactions and effectively recorded the tooling purchase for the balance due at the time of purchase.

<sup>5</sup> In its restatement, Navistar combined the adjustments to net income that resulted from vendor rebates and vendor tooling into a single line item. For fiscal year 2004, the combined adjustment resulting from vendor rebates and vendor tooling was \$11.3 million of pre-tax income, or 32.3 percent of the restated pre-tax loss for that year.

Inventory. From about 2001 through 2005, Schultz directed the plant manager of accounting to alter the Waukesha inventory numbers at the end of every month in order to improve the plant's financial operating results. Schultz failed to utilize Waukesha's designated accounting software in accounting for the inventory movements and usage and instead tracked the inventory manually, which made it easier for him to record erroneous totals. When periodic physical inventory counts taken at the plant found the recorded inventory balances to be overstated, Schultz failed to record appropriate adjustments to lower the inventory balances. As a result of this conduct, Waukesha's books falsely indicated the plant had \$11 million in inventory that did not exist, and consequently understated materials expenses by that amount.

Deferred Costs Pursuant to Purported Contractor Arrangement. Schultz deferred certain costs relating to a purported arrangement with a contractor that provided services relating to parts manufactured at Waukesha. Pursuant to a purported side agreement entered into by a former Waukesha employee, Waukesha had agreed to pay higher upfront costs to the contractor as a means to help finance the start-up of the contractor's business. In return, the contractor purportedly agreed to reduce its prices to Navistar in future periods. The agreement was not in writing; additionally, there was no evidence that the contractor guaranteed to repay any specified higher upfront costs. Nevertheless, beginning in 2002, Schultz deferred the entire dollar amount of certain of the contractor's invoices (*i.e.*, not just a portion representing higher upfront amounts paid to the contractor), effectively understating expenses in order to "smooth out earnings." Schultz deferred approximately \$2.4 million of those costs in the first quarter of fiscal 2003, and another \$700,000 in the third quarter of fiscal 2003.

Deferred Costs Involving Manufacturing Line. Schultz also improperly deferred certain costs related to Waukesha's installation of a new manufacturing line. Before installation of the manufacturing line was complete, the general contractor stopped work and filed for bankruptcy. As a result, the Company was required to pay off subcontractors' liens and pay to have the installation completed by other subcontractors. From 2002 through 2005, Schultz deferred about \$3 million that Navistar incurred in start-up expenses under the supposed theory that the Company would recover those costs from the bankrupt general contractor.

32. Schultz engaged in the aforementioned conduct in an attempt to improve Waukesha's financial results. The aggregate monetary impact of Schultz's accounting misconduct was material to Navistar's financial statements. Schultz knew or recklessly failed to know that the actions described above were not in compliance with GAAP.

c) **Warranty Reserve**

33. Beginning in fiscal year 1999, the Engine Division assumed responsibility for accounting for its warranty reserve, which reflected the Company's estimated future warranty costs on engines installed in the majority of Navistar manufactured trucks. The warranty accrual estimate process began with the Engine Division's Reliability & Quality ("R&Q") group, which generated an estimated warranty cost per unit, or CPU, for each engine sold. This calculation incorporated certain "above-the-line" items, including well-established or known steps (*e.g.*,

implemented engineering fixes) that were viewed, based on historical trends or data, to have effectively reduced warranty costs. The CPU was the primary basis for the warranty reserve amount; the higher the CPU, the higher the reserve.

34. The warranty reserve-setting process should have been governed by accounting rules related to contingent liabilities. Pursuant to Statement of Financial Accounting Standards (“SFAS”) No. 5, *Accounting for Contingencies - Appendix A; With Respect to Obligations Related to Product Warranties and Product Defects*, warranty reserves must be established when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

35. When R&Q’s CPU calculation was presented to Stanaway, and then ultimately to McIntosh, both typically stated that the initial estimated reserve number was too high for the Engine Division’s business plan. Without sufficient consideration for the relevant accounting rules, Stanaway and McIntosh typically then directed R&Q to add certain “below-the-line” items to the warranty reserve calculation process because they thought these items would reflect potential reductions that the Company hoped to achieve in future warranty costs. These “below-the-line” items included anticipated vendor reimbursements and engineering fixes<sup>6</sup> that lacked historical trend or other data evidencing their likely effectiveness. For example, Stanaway and McIntosh directed R&Q to include anticipated vendor reimbursements in the warranty reserve calculation despite the lack of any specific language in the vendor contracts providing for such recoveries. Instead, the Company relied on the existence of standard provisions in supply agreements or the Illinois Commercial Code to support the contemplated vendor reimbursements. During the relevant period, approximately 50 percent of the vendor recoveries deducted below the line from warranty reserve calculations were based on something other than specific contractual language. Moreover, the Company often did not receive reimbursements from vendors for engine warranty claims. Stanaway and McIntosh also directed the inclusion in the warranty accrual calculation of anticipated engineering fixes that lacked historical and empirical data evidencing their likely effectiveness. Certain anticipated fixes were incorporated into the CPU calculation before they had even been implemented. At McIntosh and Stanaway’s insistence, R&Q included these “below-the-line” items in its warranty reserve calculation, and these components consistently reduced the warranty reserve.

36. The inclusion of these anticipated vendor reimbursements and engineering fixes was not in compliance with GAAP. Stanaway and McIntosh knew or should have known that the warranty reserve-setting process was governed by accounting rules relevant to contingent liabilities, yet failed to consider or apply such rules in establishing Navistar’s warranty reserve. Stanaway and McIntosh also knew or should have known that including anticipated vendor reimbursements and engineering fixes without data evidencing their effectiveness was not in compliance with GAAP.

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<sup>6</sup> Vendor reimbursements concerned payments that Navistar sought to receive from manufacturers of the failed engine parts that were the source of warranty claims against the Company. Engineering fixes included engine design changes (*e.g.*, modifications to engines not yet built) and service kits (*e.g.*, modifications implemented after sale to address engine problems that arose in the field).

37. The below-the-line items inappropriately included in the reserve calculation caused the warranty expense to be understated by \$17 million in fiscal year 2002 and by \$18.5 million in fiscal year 2003. The \$18.5 million total represented 5.9 percent of the restated loss before income tax for that year.

#### **4. Reporting Failures Regarding Certain Deferred Start-up Costs**

38. In 2000, the Company entered into a long-term supply contract (the “Agreement”) with an automobile manufacturer (the “Automaker”) to develop and manufacture V-6 diesel engines commencing with model year 2002 and extending through 2012. From the fourth quarter of 2001 through the fourth quarter of 2002, the Company incurred substantial start-up costs relating to the Agreement, including expenses developing the engine, constructing a plant in Huntsville, Alabama, and leasing engine assembly assets. The Company began deferring some of these start-up costs in the fourth quarter of fiscal 2001 and as of the fourth quarter of 2002 had accumulated \$57 million of deferred pre-production costs. Production of these engines was continually delayed by the Automaker until October 2002, when it cancelled the Agreement and discontinued its V-6 engine program with Navistar.

39. Relevant accounting rules provided that such start-up costs could be deferred only if there existed an objectively verified and measured contractual guarantee of reimbursement. *See* FASB Emerging Issues Task Force Issue No. 99-5, *Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements* (“EITF 99-5”).

40. The terms of the Agreement standing alone did not provide for reimbursement in a manner sufficient to satisfy the requirements for start-up cost deferral pursuant to EITF 99-5. The start-up costs could be appropriately deferred only if the Company had received from the Automaker a written guarantee of specific reimbursement. Without such a written guarantee, the Company was not entitled to defer these costs.

41. The Company never received from the Automaker a sufficiently specific written guarantee of reimbursement. Beginning in September 2001 and continuing until October 2002, when the Automaker cancelled the Agreement, Company management repeatedly sought such a guarantee in the form of a letter. These efforts were continually rebuffed by the Automaker.

42. Nevertheless, the Company, through its senior accounting staff, deferred these start-up costs from the fourth quarter of 2001 through the fourth quarter of 2002. Specifically, the Company deferred \$4.3 million in the fourth quarter of fiscal year 2001, \$12.8 million in the first quarter of fiscal year 2002, and \$13.3 million in each of the second and third quarters of fiscal year 2002.<sup>7</sup>

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<sup>7</sup> The Company did not file an adjusted consolidated statement of operations for fiscal year 2002 or for the 2002 quarterly periods. *See supra* n. 2. Nevertheless, the dollar amounts that were deferred instead of being expensed are considered material for each of the first three quarters of fiscal year 2002. The \$12.8 million and the \$13.3 million totals represent 12.5 percent, 65.5 percent, and 25.4 percent, respectively, of the Company’s previously reported loss before income tax if adjusted to reverse these deferrals for each of the first three quarters of fiscal year 2002.

43. These deferred start-up costs were not in compliance with GAAP. While senior management did receive oral assurances from Navistar senior managers that the Automaker had in fact committed to reimburse the Company for these start-up costs and Navistar's outside auditor was aware of and accepted the continuing deferral, the Company should not have allowed the deferral because it had not received the aforementioned written guarantee of reimbursement. Navistar, like all issuers registered with the Commission, is ultimately responsible for the accuracy of its books, records and accounts.

## **5. Reporting Failures Regarding the Company's Parts Segment**

44. GAAP and Commission rules require an issuer to report specified operating result items for each business unit that is determined to be a reportable segment. *See* SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*; Regulation S-K, Item 303(A); Financial Reporting Release 54; Section 501.06 of the Financial Reporting Codification. Whether a particular business unit is a reportable segment turns on the manner in which management makes operating decisions and assesses the performance of such units. The segment reporting requirements are intended to enable investors to see an entity "through the eyes of management."

45. Prior to the restatement, Navistar disclosed that it had three reportable segments: Truck, Engine, and Financial Services. These business units met the qualifications for segments because: (1) they earned revenues and incurred expenses; (2) they had their operating results regularly reviewed by the CEO; and (3) discrete financial information was available for each.

46. However, another Navistar business unit, the Parts group, also met the segment reporting criteria. The CEO and the Board received separate monthly financial results, including sales and income, for Engine, Truck and Parts. Additionally, in the fourth quarter of fiscal year 2003, the Company announced a reorganization making the head of the Parts group a President – a co-equal with Engine and Truck – reporting directly to the CEO. The restructuring better enabled the CEO to evaluate, analyze, and make direct resource decisions for the Parts group based on the financial information available. As a result, the CEO and the Board were internally provided a transparent view of how Engine, Truck and Parts were performing independently of one another.

47. Nevertheless, from the first quarter of fiscal year 2004 through the third quarter of 2005, Navistar failed to report Parts as a segment in its publicly-filed financial statements and notes, and instead allocated the Parts group's results between the Truck and Engine divisions' results. As a result, investors were unable to view the Parts group in the same manner as were senior management and the Board. The Company's Forms 10-K for at least fiscal year 2004 and Forms 10-Q for 2004 and the first three quarters of 2005 failed to provide complete segment information required by GAAP and Commission rules.

#### **D. APPLICABLE LAW**

1. Section 17(a)(1) of the Securities Act prohibits fraudulent conduct in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraudulent conduct in connection with the purchase or sale of securities. Establishing violations of these provisions requires a showing of scienter. *Aaron v. SEC*, 446 U.S. 680, 695, 702 (1980). Scienter is “a mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Recklessness can satisfy the scienter requirement. *See David Disner*, 52 S.E.C. 1217, 1222 & n.20 (1997); *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992). Reckless conduct is conduct that is “highly unreasonable and . . . represents ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” *Rolf v. Blyth, Eastman Dillion & Co.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)).

2. Section 17(a)(2) of the Securities Act prohibits obtaining money or property by means of untrue statements of material fact or misleading omissions of material fact in the offer or sale of securities. Section 17(a)(3) of the Securities Act prohibits engaging in transactions, practices or courses of business which operate or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities. Establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter; instead, a showing of negligence is sufficient. *Aaron v. SEC*, 446 U.S. at 697 & 701-02; *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006). Negligence is the failure to exercise reasonable care or competence. *Byron G. Borgardt*, 80 SEC Docket 3559, 3577 & n.35 (Aug. 25, 2003).

3. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require all issuers with securities registered under Section 12 of the Exchange Act to file annual and quarterly reports on Form 10-K and Form 10-Q, respectively. Exchange Act Rule 12b-20 further requires that, in addition to the information expressly required to be included in such reports, the issuer must include such additional material information as may be necessary to make the required statements, in light of the circumstances under which they were made, not misleading. The obligation to file these periodic reports includes the obligation that they be complete and accurate in all material respects. *See SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex.), *aff'd mem.*, 505 F.2d 733 (5th Cir. 1974). No showing of scienter is necessary to establish a violation of Section 13(a) of the Exchange Act or Rules 13a-1, 13a-13 or 12b-20. *See SEC v. McNulty*, 137 F.3d 732, 740-741 (2d Cir. 1998).

4. Section 13(b)(2)(A) of the Exchange Act requires issuers 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.” Exchange Act Rule 13b2-1 prohibits persons from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act. Establishing violations of these provisions does not require a showing of scienter. *See SEC v. World-Wide Coin Inv., Ltd.*, 567 F. Supp 724, 749-50 (N.D. Ga. 1983); *SEC v. McNulty*, 137 F.3d 732 (2d Cir. 1998).

5. Section 13(b)(2)(B) of the Exchange Act requires all reporting companies to devise and maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP.

6. Section 304(a) of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) provides that if an issuer is required to restate its financials due to material noncompliance with the securities laws as a result of misconduct, then the CEO and CFO shall reimburse the issuer for bonuses, incentive or equity-based compensation, and/or trading profits they received during the twelve-month period following the first public issuance or filing with the Commission of the financial document required to be restated. Section 304(a) creates an obligation on the part of CEOs and CFOs to reimburse issuers by stating that, if its elements are satisfied, the CEO and CFO “shall” reimburse the issuer. If the CEO and CFO do not voluntarily reimburse the issuer, the Commission can bring an enforcement action to compel reimbursement. *See* Sarbanes-Oxley Section 3(b). Section 304 does not require that a CEO or CFO engage in misconduct to trigger the reimbursement requirement. Rather, the reimbursement requirement can be triggered by an issuer’s misconduct. Since a company can only act through its employees and agents, the misconduct of others within the company may be imputed to the company and trigger the reimbursement requirement.

7. To “cause” a securities law violation under Section 8A of the Securities Act or Section 21C of the Exchange Act, three elements must be established: (1) a primary violation, (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. *Robert M. Fuller*, 80 SEC Docket 3539, 3545 (Aug. 25, 2003). The Commission need not show that respondent's conduct was a proximate cause of the primary violations. *Rita J. McConville*, 85 SEC Docket 3127, 3146 n.45 (June 30, 2005), *pet. denied*, 465 F. 3d 780 (7th Cir. 2006). Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. *KPMG Peat Marwick LLP*, 74 SEC Docket 384, 421 (Jan. 19, 2001), *reh'g denied*, 74 SEC Docket 1351 (Mar. 8, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002), *reh'g en banc denied*, 2002 U.S. App. LEXIS 14543 (D.C. Cir. July 16, 2002).

## **E. VIOLATIONS<sup>8</sup>**

1. As a result of the conduct described above, Navistar violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 thereunder in connection with the vendor rebates, vendor tooling, warranty reserve, deferred expenses, and segment reporting matters, and Section 13(b)(2)(B) of the Exchange Act in connection with internal controls requirements;

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<sup>8</sup> This matter is related to a civil action, *Securities and Exchange Commission v. James W. McIntosh, Thomas M. Akers, Jr., James J. Stanaway, Ernest A. Stinsa, and Michael J. Schultz*, filed in the United States District Court for the Northern District of Illinois, in which these individual respondents have consented to pay civil penalties as follows: McIntosh – \$150,000; Akers – \$100,000; Stanaway – \$50,000; and Stinsa – \$25,000. A civil penalty was not imposed against Respondent Schultz because of a demonstrated inability to pay.

2. As a result of the conduct described above, Ustian and Lannert were a cause of Navistar's violations of Section 13(b)(2)(B) of the Exchange Act regarding internal controls;

3. As a result of the conduct described above, McIntosh violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and was a cause of the Company's violations of Section 13(b)(2)(A) in connection with the vendor rebates/vendor tooling matter; violated Sections 17(a)(2) and 17(a)(3) of the Securities Act in connection with the warranty reserve matter; and was a cause of Navistar's violations of Section 13(b)(2)(B) of the Exchange Act regarding internal controls;

4. As a result of the conduct described above, Akers violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and was a cause of the Company's violations of Section 13(b)(2)(A) of the Exchange Act in connection with the vendor rebates matter;

5. As a result of the conduct described above, Schultz violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and was a cause of the Company's violations of Section 13(b)(2)(A) of the Exchange Act in connection with the Waukesha matter;

6. As a result of the conduct described above, Stanaway violated Sections 17(a)(2) and 17(a)(3) of the Securities Act in connection with the warranty reserve matter; and violated Exchange Act Rule 13b2-1 and was a cause of McIntosh's and Akers' violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and was a cause of the Company's violations of Section 13(b)(2)(A) of the Exchange Act, in connection with the vendor rebates matter; and

7. As a result of the conduct described above, Stinsa violated Exchange Act Rule 13b2-1 and was a cause of the Company's violations of Section 13(b)(2)(A) of the Exchange Act in connection with the vendor rebates matter.

#### **F. NAVISTAR'S REMEDIAL EFFORTS AND COOPERATION**

In determining to accept Navistar's Offer of Settlement and not impose a civil penalty against the Company, the Commission considered the remedial acts undertaken by Navistar and cooperation it afforded the Commission staff. The cooperation included the Company's decision to conduct an independent investigation. Navistar's remedial steps, implemented in response to the independent investigation's findings and in order to cure material weaknesses in the Company's internal controls, included: terminating or removing from financial reporting responsibilities various employees who were identified in the internal investigation as having committed intentional misconduct; adding more than 100 new finance and accounting employees with accounting backgrounds, including a new Director of Accounting Compliance and new accounting compliance managers and analysts in the Truck and Engine divisions; creating a new position, Corporate Compliance Officer, who is responsible for overseeing compliance with federal and



state law and Company policy; realigning reporting chains so that finance personnel within the Engine and Truck divisions now report directly to the CFO, and not to operations managers; engaging consultants to improve warranty cost accounting models and methodologies; implementing new accounting policies and procedures; and instituting new employee training on internal controls and ethics.

**G. UNDERTAKINGS**

1. The goal of these undertakings is to achieve voluntary compliance with Section 304 of Sarbanes-Oxley.

2. To satisfy the forfeiture provisions of Section 304 of Sarbanes-Oxley, Ustian shall tender to the Company a sufficient number of shares of unrestricted Navistar common stock currently owned by Ustian to produce proceeds of \$1,320,000 net of fees and commissions at the time of transfer. The time of transfer shall be the intraday market price at the time the shares leave Ustian's possession as determined by Ustian's brokerage firm. The \$1,320,000 total represents a *pro rata* portion of Ustian's 2004 bonus based on the percentage of the Restatement Period during which Ustian was CEO of the Company. Ustian may make these transfers of stock on one or more occasions, so long as he completes the tender within 90 days after institution of this Order. Counsel for the Company shall confirm receipt of the shares from Ustian and the intraday price, the number of shares transferred, and the time the shares left Ustian's possession. This confirmation shall be sent to C. Joshua Felker, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5030, within seven days following the close of the 90-day period.

3. To satisfy the forfeiture provisions of Section 304 of Sarbanes-Oxley, Lannert shall pay the Company a total of \$1,049,503, representing his 2004 bonus, within 90 days after institution of this Order. The payments shall be by certified check, bank cashier's check, or United States postal money order payable to Navistar International Corporation, and shall be delivered or mailed to Navistar International Corporation, c/o Curt A. Kramer, Associate General Counsel and Secretary, Navistar, Inc., 4201 Winfield Road, P.O. Box 1488, Warrenville, IL 60555, and shall be submitted under cover letter that identifies Lannert as a respondent in these proceedings and the file number of these proceedings. A copy of the letter and check or money order shall be sent to C. Joshua Felker, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5030.

4. In determining whether to accept Ustian's and Lannert's Offers of Settlement, the Commission has considered these undertakings. Ustian and Lannert agree that if the Division of Enforcement believes that they have not satisfied these undertakings, it may petition the Commission to reopen this matter to compel compliance with Section 304 of Sarbanes-Oxley and determine whether additional sanctions are appropriate.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

- A. Navistar shall cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder;
- B. Ustian shall cease and desist from causing any violations and any future violations of Section 13(b)(2)(B) of the Exchange Act;
- C. Lannert shall cease and desist from causing any violations and any future violations of Section 13(b)(2)(B) of the Exchange Act;
- D. McIntosh shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and from causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act;
- E. Akers shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and from causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act;
- F. Schultz shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and from causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act;
- G. Stanaway shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder and from causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act; and
- H. Stinsa shall cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13b2-1 and from causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act.

By the Commission.

Elizabeth M. Murphy  
Secretary