

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59500 / March 4, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2942 / March 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13389

In the Matter of

Sherry J. Polonsky

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO 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 pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Sherry J. Polonsky (“Polonsky” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) 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 herein, except as to the Commission’s jurisdiction over her and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to 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 Respondent's Offer, the Commission finds¹ that:

Respondent

1. Polonsky, 47 and a resident of Winston-Salem, North Carolina, was Vice President of Finance and then Senior Vice President of Finance for Krispy Kreme Doughnuts, Inc. ("Krispy Kreme" or the "Company") between January 2002 when she joined the Company and her resignation on June 17, 2005. Krispy Kreme is a public issuer and doughnut retailer and franchisor based in North Carolina. Polonsky's responsibilities at Krispy Kreme included overseeing segments of the Company's accounting, financial reporting, and tax functions.

Overview

2. In the third and fourth quarters of Krispy Kreme's 2004 fiscal year, Polonsky caused Krispy Kreme to record improperly two round-trip transactions in connection with the acquisition of Company franchises located in Michigan and California. In both transactions, Krispy Kreme paid money to the franchisee with the understanding that the franchisee would pay the money back to Krispy Kreme. In each instance, Krispy Kreme recognized additional income in an amount roughly equal to the funds that were paid back to it.

3. As a result, Krispy Kreme filed annual, quarterly, and current reports with the Commission that contained misstated financial results, failed to have books and records that accurately and fairly reflected its transactions and disposition of assets, and failed to devise and maintain internal accounting controls sufficient to provide reasonable assurances that its accounts were accurately stated in accordance with generally accepted accounting principles.

First Round Trip Transaction

4. The first round trip transaction occurred at the end of October 2003, four days before the closing of Krispy Kreme's third quarter of its fiscal year 2004, in connection with the acquisition of a franchise located in Michigan.

5. Specifically, as part of the acquisition transaction, the Company agreed to increase the price it paid for the franchise by \$535,463, which represented an approximation of the total of two amounts that Krispy Kreme claimed it was owed by the franchisee, with the understanding that the franchisee would pay the disputed amounts to Krispy Kreme as part of the acquisition's closing. The Michigan franchisee had refused to pay these amounts and only agreed to pay them after Krispy Kreme offered to increase the purchase price in an amount intended to cover the disputed items.

6. Polonsky was told in an e-mail that the purchase price for the franchise would be increased by the approximate total of the two disputed amounts so that those amounts would be paid to Krispy Kreme as part of the acquisition's closing. In addition, a coworker discussed with Polonsky increasing the purchase price to resolve remaining issues. Despite the email and this

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

conversation with the coworker, Polonsky directed that Krispy Kreme recognize income and reclassify expenses in an amount equal to the total of the two disputed items.

7. As a result, when the acquisition closed, Krispy Kreme paid an increased purchase price of \$535,463, and recorded the transaction on its books and records as if it had been paid for the two disputed amounts. This overstated the Company's net income in the third quarter by approximately \$310,000 after taxes.

Second Round Trip Transaction

8. The second round-trip transaction occurred in January 2004, in the fourth quarter of Krispy Kreme's 2004 fiscal year, in connection with Krispy Kreme's acquisition of the remaining interests in a franchise located in California, in which Krispy Kreme already owned a majority interest.

9. Specifically, beginning in or about October 2003, Krispy Kreme initiated negotiations with the remaining interest holders for acquisition of their interests. During those negotiations, the franchise manager of the California franchise, who individually owned 25% of the franchise, ceased to manage the California franchise and Krispy Kreme, through its employees, assumed his management responsibility.

10. During the course of negotiations, Krispy Kreme sought from the former franchise manager a "management fee" as compensation to Krispy Kreme for the handling of his previous management duties after October 2003. Krispy Kreme suggested that such a fee be subtracted from any amounts due the former franchise manager at closing for his 25% interest in the franchise.

11. The former franchise manager refused to agree that any amount should be deducted from the proceeds of the sale of his interest to Krispy Kreme.

12. A few days before the scheduled closing of the transaction and only about a week before the end of the fourth quarter of Krispy Kreme's 2004 fiscal year, Polonsky communicated to the former franchise manager a proposal by Krispy Kreme that he accept a distribution from his capital account in the franchise, that he could then pay back to Krispy Kreme as a management fee. The former franchise manager was further told that at closing he would still receive the full amount of the previously negotiated consideration for his 25% interest in the franchise.

13. By offering a non-pro rata distribution from the former franchise manager's capital account while at the same time assuring the former franchise manager that he would receive the full amount of the previously agreed upon consideration for his 25% interest, Krispy Kreme was orchestrating a round-trip transaction that lacked economic substance.

14. Krispy Kreme made a distribution to the former franchise manager from his capital account in the amount of \$597,415, which he immediately transferred back to Krispy Kreme as payment of the management fee. Polonsky caused Krispy Kreme to book this fee as income, thereby overstating Krispy Kreme's net income in the fourth quarter by approximately \$361,000 after taxes.

Respondent's Violations

15. As a result of the conduct described above, Polonsky caused Krispy Kreme to violate Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13, thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual, quarterly, and current reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

16. As a result of Polonsky's actions, Krispy Kreme's books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

17. In addition, as a further result of Polonsky's actions, Krispy Kreme failed to devise and maintain a system of internal accounting controls relating to its franchise acquisitions that were sufficient to provide reasonable assurances that its accounts were accurately stated in accordance with generally accepted accounting principles.

18. As a result of the conduct described above, Polonsky caused Krispy Kreme to violate Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

19. Lastly, as a result of the conduct described above, Polonsky caused Krispy Kreme to violate Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Polonsky's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, Respondent Polonsky cease and desist from 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, 13a-11, and 13a-13 thereunder.

By the Commission.

Elizabeth M. Murphy
Secretary