The Universal Effect of Fraud in the Accounting Field

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The Universal Effect of Fraud in the Accounting Field

An Honors College Thesis

by

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School of Professional Accountancy

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Date
Abstract

In this thesis, I will explain in detail the impact fraud can have on the accounting profession. I will first discuss the basics of financial statements, including what they accomplish and how they pertain to the purpose of auditing. Next, I will explain the Generally Accepted Accounting Principles and how they, too, tie into the auditing process. Since it will be necessary to provide a background on auditing, I will incorporate this as my third topic. The fourth main topic will be the Sarbanes-Oxley Act of 2002, where I will describe its implementation into the accounting field. This will lead to my discussion on the Public Company Accounting Oversight Board and the ways in which it works to prevent accounting fraud. My final argument will address the types of accounting fraud, which will guide me to provide examples of past accounting fraud cases that eventually shaped the auditing profession.
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Businesses and entities run smoothly under precise conditions, such as outstanding leadership, a solid mission, goal-seeking employees, and proper financial reporting. Financial reporting is one of the key functions every entity must do. This involves several requirements, such as reporting financial position, results of operations, cash flows, and disclosures. Each financial statement is designed to report specific information about an entity’s financial statements. Essentially, financial reporting is a way to communicate to outside parties how an entity is doing financially. These entities may include companies, not-for-profit organizations, or governments. In this thesis, I will first discuss the basics of financial statements, including what they accomplish and how they pertain to the purpose of auditing. Next, I will explain the Generally Accepted Accounting Principles and how they, too, tie into the auditing process. Since it will be necessary to provide a background on auditing, I will incorporate this as my third topic. The fourth main topic will be the Sarbanes-Oxley Act of 2002, where I will describe its implementation into the accounting field. This will lead to my discussion on the Public Company Accounting Oversight Board and the ways in which it works to prevent accounting fraud. My final argument will address the types of accounting fraud, which will guide me to provide examples of past accounting fraud cases that eventually shaped the auditing profession.

Financial statements can be quite complex considering all the information that is entered onto them. There are four standard financial statements that entities use to disclose their financial position. These statements include the income statement, cash flow statement, balance sheet, and statement of owner’s equity. Although each of these is necessary, they all have their unique qualities. On the income statement, an entity’s revenues and expenses get reported. “Revenue” is simply an interchangeable term for earnings. In other words, revenue is the amount of money the entity brings in before having to account for its expenses. On the other hand, expenses are
whatever cost the entity money. After these are incurred and deducted from the revenues, an entity is either left with a net income or a net loss. If revenues exceed expenses, there is a net income. In contrast, if expenses exceed revenues, a net loss is present. The next financial statement is known as the statement of cash flows. This particular statement is broken down into three categories: operating activities, investing activities, and financing activities. Ultimately, this statement measures changes in balance sheet accounts, accounting for both inflows and outflows of cash. The third essential financial statement is called the balance sheet. Another name for the balance sheet is the “statement of financial position” because it is an up-to-date financial statement where every line item is in its current amount. Included on the balance sheet are assets, liabilities, and owner’s equity. Assets are resources that an entity possesses that will provide a future economic benefit. Liabilities are essentially financial obligations and are the opposite of assets. The final part of a balance sheet is the owner’s equity portion. In simple terms, owner’s equity is what is left over when you subtract the value of the liabilities from the value of the assets. It represents the owner’s net investment in the company. Owner’s equity gets disclosed on a separate financial statement known as the statement of owner’s equity. This gets calculated by starting with the beginning balance, adding net income, and deducting any withdrawals made. All four of these financial statements are standard when it comes to reporting and being audited. Reporting fairly on them is exceptionally crucial.

The significance of presenting fairly is extremely high. Most financial reporting is done under the regulations of the Generally Accepted Accounting Principles, or GAAP. If this reporting is not done in a careful, precise manner, the entity may be accused of reporting unfairly. It is extremely crucial to avoid this because entities may suffer severe consequences as a result. However, by following GAAP, entities are almost guaranteed to produce a fair report.
The Securities and Exchange Commission, otherwise known as the SEC, only requires publicly traded and regulated companies to follow GAAP. A publicly traded company is one that issues stock to outside investors. Some examples of these companies are Apple, Netflix Inc, and Target, among thousands of others. However, companies are not the sole type of entity that must report under GAAP. Additionally, not-for-profit organizations must follow the Generally Accepted Accounting Principles as well. The expectation of an entity is to output the most accurate information about its financial condition, result of operations, and cash flows. The Generally Accepted Accounting Principles were set by two boards that reside under the Financial Accounting Foundation—the Financial Accounting Standards Board and the Governmental Accounting Standards Board. These names are interchangeably used as FASB and GASB. The difference between these two boards is that the FASB does not set any standards for governments unlike GASB that creates the standards strictly for governments. Furthermore, governments do not follow the GAAP standards set by the FASB, but a different set of standards set by the GASB. We will focus more on the GAAP principles made by the FASB because most accounting fraud that is committed stems from the violation of these.

A handful of main principles fall under GAAP and by having them categorically split, it can be simpler for entities to comply with them. The main principles include consistency, disclosure, going concern, historical cost, matching, materiality, and monetary convention. Now, we will discuss them a bit further. Consistency means that it is necessary to stick with the same methods, reporting periods, and overall rules while reporting. If you were to use a different method each time, then it may indicate to auditors that you may be attempting to commit fraud. Even if that is not your intention, it still raises quite the red flag. So, it is extremely important to use consistency. The next major principle is called disclosure. This principle is exceptionally
imperative because it means that you will include all your transactions in your reporting. In other words, it is like a promise that an entity or organization will not attempt to make its numbers look better on statements in hopes to avoid financial consequences. If one alters any transactions, or refuses to disclose some, it is fraud and is criminally punishable. Next, we have the going concern principle, which simply states that it is assumed that the business will continue forever. The historical cost principle consists of recording transactions at their actual cost no matter what. Moving along, the matching principle is a bit more complex. An entity that complies with the matching principle will report their revenues that match their expenses in the same period onto their income statement. Materiality is the next GAAP principle and means that information reported may be grouped by significance when it comes to influencing decisions. This eliminates the need to disclose similar information separately. Lastly, monetary convention is giving everything a monetary value in order to communicate in one language—money. Applying a monetary value to all items allows us to compare and contrast more effectively. Again, these standard principles provide direction to entities in regard to the correct way to report their financial results.

Although entities and companies are expected to follow the Generally Accepted Accounting Principles precisely, the principles may be too difficult to follow at times. Evidence has surfaced that indicates that there may be problems with GAAP, which can further explain why entities have a difficult time following the principles to a certain extent. Some authorities claim that, at times, adherence to GAAP is not sufficient and that fairness should override GAAP in these instances. Rule 203 of the American Institute of Certified Public Accountants Code of Professional Conduct says, “This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles
would have the effect of rendering financial statements misleading.” In 1969, there was a specific court case that addressed this confusion. The case was called *US v. Simon (1969)* and the ruling stated that accountants would be held criminally liable for misleading shareholders even if they complied with GAAP in a perfect sense. The remainder of this case will be addressed later on. Most definitions of the phrase “present fairly” simply state that there needs to be a compliance with GAAP. According to these standard definitions, as long as you comply with the GAAP principles, then you are said to be presenting in a fair manner. Hence, it is understandable for there to be much confusion. On the other hand, it is the auditor’s job and responsibility to know how to follow GAAP in both a technical sense and by using overall good judgement.

Auditors are expected to know how to utilize GAAP to check entities’ financial statements. Auditing is a crucial process in both the business world and accounting profession because it holds entities accountable for providing a true, honest representation of their financial positions. The goal of an audit is to take necessary records and statements of a company and provide an objective report on whether an entity is following protocol in regard to reporting. There is such thing as a follow-up audit that can be conducted after a normal audit. Follow-up audits are only needed if the original audit flagged an issue and needed to be corrected. Otherwise, only one audit is performed. Before this occurs, the individual or group performing the audit must evaluate the type of audit that needs to be carried out. There are three main types of audits—product, process, and system. A product audit is checking a product or service to make sure it complies with the regulations dedicated to it. These regulations may include specifications, performance standards, and customer needs. The second type of audit is a process audit, which consists of making sure a process is following proper protocol. Just as products have to meet their standards, processes and methods must meet their benchmarks, too. Lastly, the
The third main type of audit is a system audit. System audits are unique because they involve checking a management system and have subcategories to them. For example, one subcategory under a system audit is known as a quality management system audit which involves analyzing a quality program to confirm that it is meeting all requirements. The other subcategories include an environmental system audit, a food safety system audit, and a general safety system audit.

In addition to the three types of audits, there are various-party audits. The first is known as a first-party audit and is done internally, meaning that the organization performs its own audit. The purpose of this is to assess how the organization’s methods are working in comparison to external standards. A second-party audit differs from a first-party audit in the sense that it is an external audit between a customer and a supplier. The customer can either choose to perform the audit oneself or can hire a contracted organization to perform it for him or her. Results of this audit can strongly influence a customer’s purchasing decisions. Contract law is intertwined with a second-party audit as well because it is an engagement between a supplier and a customer. Lastly, a third-party audit rules out any conflict of interest because it is done by a completely separate organization that is not involved in the transaction between the supplier and the customer. This is the most formal out of all the various-party audits.

The auditing process is very complex and consists of several stages. Before an audit is conducted, it must be prepared. This is the first step—audit preparation. When auditors are preparing the audit, they must make certain that it will fulfill the client’s objective. The preparation stage begins when there is a decision made to make the audit and ends when the audit is started. After the audit preparation stage, the auditor eases into the performance portion of the audit, also known as the second stage. Another term for this stage is the “fieldwork.” Some of the activities included in this portion are going to the location, conversing with the auditee,
and gathering all necessary data. The third stage is audit reporting, which is essentially communicating the results of the audit to the auditee. Finally, the fourth stage of the audit process is the follow-up and closure. A follow-up is only needed if something should be corrected. If all the objectives have been met, the audit is complete.

The auditing process is crucial in flagging accounting fraud, which is why we discussed it heavily. Without auditing and all the protocol that goes along with it, we would never have the ability to truly catch fraudsters. As a result, the economy and the stock market would be threatened in an extremely negative way. For example, if a company relayed a lie of having overstated earnings and revenues to its shareholders and then the stock value proceeds to drop drastically, the shareholders will lose large sums of money. There are numerous cases that have occurred that have produced this unfortunate outcome, which will be discussed later on. Obviously, fibbing to outside shareholders and creating a stock market crash is a huge problem that needs to be avoided at all costs. Resultantly, audits are performed. The types of audits fall under two general categories—internal and external. There are a handful of characteristics that each of these two categories have that set them apart from each other. One of these involves the objectives of each audit.

For internal audits, the objective is more performance-oriented and focuses on how a company can capitalize on making improvements. An auditor will come in and look over a company’s documents and strategies. Afterwards, the auditor will offer suggestions on how the company can make specific improvements to create a more efficient way of how it is run. Increasing efficiency can often times increase effectiveness. Although some may argue that efficiency and effectiveness are interchangeable terms, they are quite different—especially in accounting. Efficiency means getting something done, regardless of the quality of the process in
which it was done. With that being said, effectiveness is different because it focuses more on the outcome of a task that is completed, such as how well it was done and what you can take from it. If something is done effectively, it is typically done in a proper manner with little room for questioning. It can also provide results that are helpful and that drive people or ideas in the right direction. To relate this back to accounting, it is crucial to complete objectives effectively, especially when auditing, because companies are trusting the certified public accountants to provide the best results possible. By taking their time, being organized, and following the correct procedures, auditors will most likely produce an effective end product. According to I.S. Partners, LLC, an internal audit can be much more effective than an external audit. There are several reasons behind this, with one of them being that an internal auditor is physically hired by a company to grant expert advice on how to improve the company. This person is generally trusted by the organization because he or she can provide his or her expertise objectively. Another difference between internal and external audits that may make an internal audit more effective is the objective of the audit. Internal audits yield outcomes that genuinely help the company itself, including advice about how to improve. In contrast, external audits are done to verify that an entity’s financial statements comply with the requirements they must meet.

An external audit is done to assure that the entity is complying with rules and regulations that are set upon it. Furthermore, according to I.S. Partners, LLC, “the objective of an external audit is to give reliability and credibility to the financial reports that go to shareholders.” The Securities and Exchange Commission requires that publicly traded companies get externally audited once every year. In her academic article, “The Principles and External Audits,” Julie Gable says that, “audits are particularly stringent in industry sectors where regulators have a duty to protect the public” (25). By setting this requirement, the SEC hopes to reduce, if not eliminate,
fraudulent activity within entities and organizations. As a further result, it prevents shareholders and investors from losing their money. With these external audits, the SEC will sometimes give a two-week notice to the entity that they will be getting audited. Although it may not be the timeliest warning, it does prepare the entity to get organized for it to take place. However, some entities are not so lucky, and do not get any type of warning. Random audits occur and force companies to present the financial statements they have on hand at that moment in time. If they have been honest about their numbers and have done their procedures correctly, then these surprise audits tend not to be bad. On the other hand, if a company or organization is committing accounting fraud and an external auditor shows up unexpectedly to perform an audit, then there is a good chance that its fraudulent activity will be put to an end and will lead to further consequences.

A common misconception with auditing is that it is only conducted when something is wrong. If this was the case, auditing would not be such a popular profession because there would not be a high demand for it. Auditing is a tremendous tool that can truly boost a company’s production and internal processes in order to create effectiveness, as previously mentioned. Not only does the auditing process accomplish this, but it also holds companies accountable for producing fair financial statements. In summary, there is much more to auditing than investigating wrongful actions. It can benefit companies in numerous ways and can possibly prevent certain things from going wrong. However, some people do not perceive auditors as being helpful people, but rather cruel and unpleasant. It can be said that auditors are often times unwelcomed into companies because they are seen as being the “bad guys.” Management might panic when auditors arrive to the premises, especially if it is a surprise audit. These circumstances produce an extremely unhealthy relationship between the auditor and the company
being audited. This unfortunate situation can be prevented, which can then create a smoother process. In fact, one solution can be for auditors to build a stable emotional intelligence, also known as emotional quotient.

Emotional intelligence is essentially understanding your own emotions, along with others’ emotions, and how to manage them in a positive way. There are two types of competence that go into emotional intelligence—personal competence and social competence. Personal competence is focusing more on oneself and what goes on internally. The three skills that fall under personal competence, in order, are self-awareness, self-regulation, and motivation. Self-awareness involves recognizing one’s emotions as they occur and is crucial because it prompts more control over situations. This is the base that sets up the next two skills. The next skill is self-regulation, and someone portrays this by managing the emotions they recognized in the self-awareness stage. Eventually, this leads to the last skill—motivation. In this phase, understanding emotional motivations is key. In other words, one should learn what triggers certain emotions and how to utilize these emotions to progress toward whatever goals have been set. Social competence, the other type of competence, differs from personal competence because the main concentration is on other people’s emotions. There are only two skills that coincide with social competence—empathy and social skills. Empathy is the ability to put yourself in someone else’s shoes and attempt to fully understand their emotions and behaviors. Ironically, this is one of the most important skills an auditor can have. Most people believe that auditors are not allowed to be empathetic, and therefore they must eliminate all human attributes in order to produce a quality audit. Yet, that is far from the truth. As the auditor, understanding what the client is encountering and is going through will ultimately benefit the interpersonal relationship between the two. This is because it will most likely spark an understanding in the client as well, and the respect will be
reciprocated. When respect and empathy are mutual, common goals can be reached in a more effective manner. Now, this only applies to internal auditing because of there is a better possibility of the formation of a relationship.

Building the interpersonal relationship, along with emotional intelligence between the client and the auditor, is a process. In other words, it tends not to happen very quickly. When an auditor is hired by, or assigned to, a client, an interview is conducted so that the two can get familiar with each other. Having full communication with the client can benefit the auditor when it comes to setting up the audit. If the client is comfortable with the auditor, the terms of the audit, and the end goal of the audit, then the auditor is typically going to earn the client’s trust. Next, the two hold meetings with each other to further discuss the procedures involved with the audit. Just as in the interview, the auditor must pay close attention to the client’s emotions during meetings and practice superior emotional intelligence. Other than the requirement of the same level of emotional intelligence being present, interviews are quite different from meetings. Interviews typically involve only the auditor and the client being audited. However, in meetings, several more people may be in attendance, which causes the auditor to have to adapt to everyone’s emotions rather than only those of one person. This can be challenging, but if the auditor exemplifies his or her strong emotional intelligence, he or she will be able to inform everyone adequately and get everyone on board. Another way to positively form an interpersonal relationship is to be extremely clear when reporting the results of the audit. For example, the auditor can provide a brief description of what to expect within the findings before the official report to allow the client to prepare for what he or she is about to discover. Finally, it is important for the auditor to allow fellow auditors to give feedback on the overall quality of their
particular work. There is always room for improvement, so this can help the auditor assess his or her work and can ultimately uncover what he or she can improve on next time.

The relationship between the auditor and the client is much more important than one may think. If it is built and maintained the proper way, through all types of situations, then audits are more likely to run smoothly. Otherwise, problems that may present themselves along the way could worsen exponentially. When an internal auditor agrees to check over a company, the company is putting its utmost trust in the auditor to return a fully objective report. If this objective is tampered with, the company could be given a biased report that could possibly get them into trouble down the road. For example, if an auditor works within a company and is assigned to perform an audit on his company, he may be more inclined to produce a biased result in order to keep his superiors happy. This can be a tremendous issue because if he clears the company and assures that everything is correct on the financial statements when it is not, then this could evolve into a legal situation in the future. If the problem is never addressed, then there is a high chance that future financial statements produced by the entity will also be prepared wrongfully. In other words, fraud may be committed.

For fraud to exist, typically three conditions must be present. The first condition is the existence of an incentive or the threat of pressure. It is not unusual for employees to be bribed by management to commit fraudulent acts. Some of these incentives may include a raise, more time off, or more stock in the company if the company is publicly traded. Employees tend to give in at times because they see the benefits as being much greater than the risks. On the other hand, employees are sometimes threatened by management to come up with false numbers on the company’s financial statements. Although this typically only happens in extreme cases, superiors can threaten demotion or termination to the employees who fail to agree to carry out these
actions. The second condition that is present when fraud occurs is an open opportunity. In other words, internal control might weaken or fail, opening the door for fraud. It is awfully simple to maneuver around weak controls because if there are barely any protocols to follow, then there is less to be held accountable for. Unfortunately, this is an extremely messy situation, which is why having good internal control is essential. Making attempts and implementing policies to prevent fraud will tremendously reduce these open opportunities. Lastly, the third condition that goes hand-in-hand with fraud is the rationalization or attitude from the perpetrator. Whoever commits the fraud may try to rationalize with himself or herself that what he or she did is completely acceptable. They may try to convince themselves that nothing was unethical about it and continue onto their next task. Having a solid, true code of ethics can inhibit the temptation of fraud. Dishonesty is extremely unacceptable in the accounting field because accountants are expected to be one of the most trustworthy professionals. Together, these three conditions are called the Fraud Triangle. They occur simultaneously when fraud is being committed.

The three elements of the fraud triangle are significant to the overall motive behind committing fraudulent behavior. To elaborate more on the incentive and pressure portion, it can easily be said that there is more to this risk factor. Management, too, feels pressures and incentives, which explains why they then push their employees to commit. Some pressures that can be felt include the threat of the business going under, not being able to meet the profitability objectives, or a great likeliness of a dip in management’s personal salaries due to a drop in profitability. As the saying goes, desperate times call for desperate measures, and although carrying out fraud is completely unacceptable, sometimes the pressures are so weighty that management uses them as a way to rationalize fraud. In contrast, the superiors of a company are tempted to conduct fraudulent actions because they discover benefits they can reap from it. A
handful of these incentives are increasing the level of the company’s presence in the pool of competition, driving competition out, growth in earnings, and an impactful increase in profitability. More earnings for the business mean a larger sum of money going into management’s pockets. Unfortunately, some people in these higher positions are willing to risk being caught committing a felony to temporarily gain more earnings. The implementation of SAS No. 99 significantly reduced this.

If we revisit the second portion of the fraud triangle, we reiterate that it is the opportunity to execute the fraud. Some of these opportunities consist of complex transactions the business is involved in, international business that requires different taxation, little supervision of management and their decision process, weak internal control, ineffectual accounting and information systems, and constant fluctuations in the organizational structure. Let us look more closely at each of these possibilities. Accounting is not always a simple process, hence the existence of intricate transactions. A prime example of one of these is a business merger, or when two separate businesses become one. As a result of the two coming together as one, both of their financial statements need to be combined. This is called the consolidation process. It consists of multiple parts and requires a lot of precision. If it is not done correctly, it could either overstate or understate numbers, which can cause significant problems. If an account such as sales is overstated, then this serves a wrong impression on the company’s progress to outsiders. Essentially, it tells the public, especially shareholders, that the company is thriving even though it may truly be suffering. Since there is a lot that goes into consolidation, every so often representatives of a company assume that it is more difficult for auditors to catch errors. Another example of a possibility for opportunity is various forms of taxation throughout the world. In some countries, taxes are lower; so, when conducting business in foreign countries, tax amounts
might get lost in translation when reporting them. Next, management might not have anyone holding them accountable for their actions. Therefore, it can be simple to manipulate numbers if there are no immediate consequences. Having weak internal control is almost a huge incubator for fraud. If the organization has little to no standards of what is right and wrong, then it will be fairly easy to lose control over financial statements. Lastly, organizational structure within a business is key. If it is strong and stable, it is less likely that accounting fraud will occur. On the other hand, if positions are constantly changing and being filled by various people regularly, then it becomes challenging to consistently report to people if the people you need to report to are changing often. A consistent organizational structure helps with this.

Rationalization is the third and final risk factor when it comes to fraud. Typically, fraudsters will try to make sense of their actions to make them appear less severe. This can be done for several reasons. One reason is that the organization might have loose interpretations of ethics and therefore, might have inadequate ethical standards. If this carefree attitude gets passed along to the employees, then they will be less inclined to do what is morally correct. Another reason is that there have been instances in the past where questionable behavior was disregarded. Laws may have been broken, but nothing was done about it. So, this sets the tone for how employees will be punished, or not punished, for future offenses. Additionally, if problems with a company’s internal control system fail to be corrected, then the company is more susceptible to the rationalization risk factor. The largest reason behind rationalization is that management is far too worried about and invested in growth rates and stock prices. Of course, all companies desire to thrive in the stock market, but that is not an excuse to commit fraud. That must happen naturally and legally. Yet, some people in authority within an organization will go great lengths to cut corners and disregard the legality factor. What sets this particular risk factor apart from the
other two risk factors is that the auditor typically cannot observe this and, instead, must infer that this may have been going on. More often than not, management will refuse to confess that they rationalized their wrong actions. This is why it is important for the auditor to consider it when searching for any of the mentioned factors stemming from the fraudulent financial statements. In summary, if at least one of the three risk factors are present, the audit procedures need to be strengthened.

Regardless of how many standards are put into effect and how adequately the auditor does his or her job, accounting fraud can still happen. So, it is almost always an excellent idea for a company to have an internal auditor who can objectively assess the situation if the company is being accused of fraud. Typically, organizations have employees who are trained to examine fraud and are able to objectively analyze financial statements for fraudulent behavior. Regardless of their standing in the company, they are trained to give their expert opinion, without feeling inclined to defend the company. If there is evidence of fraudulent behavior, it is crucial for the auditor to do things a certain way or else circumstances can worsen greatly. Handling an internal investigation properly can be the difference between a resolution and a massive downward spiral.

First and foremost, auditors are expected to solely look at the facts during an investigation. This is where the objectiveness kicks in. Establishing the facts in these situations is vital because in order to assure the company that they did something wrong, there must be evidence. If the accountant fails to acquire all the facts, there is a chance the company will overreact and force litigation upon the accountant. It may result in a legal issue because the company’s name could potentially be harmed. In his article in Compliance Week called The Reasonable Person: Internal Audit's Role in Internal Investigations, Jose Tabuena says, “a good internal investigation can prevent potential whistleblowers from having to seek government
Intervention.” Whistleblowers are individuals who disclose private information to more powerful sources intentionally. Although at times it escalates into that, most times it does not and instead gets reported internally. Reporting confidential information to higher officials, such as the government or lawyers, is an extreme measure that a majority of people are timid to resort to. This is why concerns are almost always made aware internally first; then, if it does not get resolved internally, people will make the tactical decision to involve government officials or law experts. If officials and those within the company feel it is appropriate, an independent investigation is conducted. Furthermore, this depends on how severe the addressed situation is. If a company is being accused of fraud, especially publicly, then carrying out a more formal investigation is best. In general, deciding whether a further investigation needs to be done requires a handful of considerations. These include the nature of the matter, the riskiness of the matter, if it is a recurring issue, and the need to provide clarity for the organization’s reputation. In addition, it is important for whoever is conducting the investigation to be properly trained.

Certified fraud examiners can be huge assets to a company, especially if they are employees. As previously mentioned, it is possible for someone who works for the company to perform the investigation regarding the company. Although it is possible, it can be a slippery slope. If not done the proper way, and if the employee does not stay committed to the ultimate task at hand, then it could turn into a major conflict of interest. In order to stay focused, it is essential that they are thoroughly trained to complete the task. One of the key items they are told to look for is deception, meaning that they drop any trust they have in the company to truly assess. Once the internal auditor, who is also the employee, begins advocating for the company, then the investigation should be put to an end and an external source should be used instead. At this point, the process needs to be restarted. However, if the employee stays true to the
assignment, it can benefit the company greatly. Eliminating the need for an external source can keep the company out of the public eye and prevent any scrutiny. Everything could stay within the company, which keeps the name in good standing. Now, if the entity chooses to hire an auditor who does not regularly work for the company, the auditor is obligated to follow the same techniques. For example, he or she must also search for any activity that is intended to deceive others. In fact, auditing approaches were lacking so much that in 2002, the Accounting Standards Board of the American Institute of Certified Public Accountants released Statement on Auditing Standard—abbreviated as SAS—No. 99.

Statement on Auditing Standard No. 99 was established to give those in the auditing profession guidance on how to detect fraud within financial statements. Prior to the establishment of SAS No. 99, Statement on Auditing Standard No. 82 was in effect, but was reformed into SAS No. 99 approximately five years later. The request to revise was made by the American Institute of Certified Public Accountants, otherwise known as the AICPA, because they felt it was not as strong as it should have been. The awareness of the severity of accounting fraud was high, and although Statement on Auditing Standard No. 82 was extremely helpful, the AICPA knew auditors needed a little more direction. SAS No. 99 became an easier guide to follow, which decreased the pressure put on auditors. This new and improved auditing standard focuses on classifying the three fraud risk factors included within the fraud triangle that we touched upon earlier. In SAS 99—Consideration of Fraud in a Financial Statement Audit: A Revision of Statement on Auditing Standards 82, authors Patrick Casabona and Michael Grego discuss the new standard as opposed to SAS 82, and state, “the new standard will result in a greater emphasis on professional skepticism, a partner-led discussion of fraud assessment with all of the members of the audit engagement team as part of the planning process, and additional
procedure to obtain information needed to identify the risks of material misstatement due to fraud, including inquiries of management and others, and analytical procedures.” Essentially, these advancements will hopefully keep auditors engaged and focused on the task at hand. Since it is set up to make the process easier for people in this profession, auditors are more likely to perform the duties of their job correctly, which could mean an improved rate of fraud detection.

SAS No. 99 addresses revenue recognition, which was previously not included in SAS No. 82. In accounting, revenue recognition refers to a specific principle that requires entities to “count” revenue when it is earned. For example, let us say you want to plan a trip to California for next month. You go onto the Delta Airlines website and purchase your ticket. When you submit your payment, Delta receives it, but they cannot include that in their earned revenue just yet. This is because Delta has not provided the service for you yet. So, when you get onto the Delta airplane the next month and it successfully takes you to California, they have now fulfilled their portion of the transaction. Therefore, Delta can now count your payment as earned revenue for their company. Accountants call this “recognizing revenue” and SAS No. 99 now uses it as a component for auditors to investigate. This will be used particularly in financial statement audits because this is where revenue resides. With this improved accounting regulation, auditors are given more responsibility in order to take safer measures. One of these forms of responsibility consists of auditors ensuring the company is making correct journal entries and that management is not attempting to override controls. Those in the auditing profession need to be fluid in their ability to create journal entries, too, because they are critically assessing those produced by companies. If the auditors do not know how develop journal entries properly, then they cannot be expected to be aware of how to check for correctness. Although these are extra tasks brought upon the auditors, it becomes an essential step.
The extra work involved in following the guidelines for SAS No. 99 results in more meetings and strategizing amongst the team members who are working together to conduct the audit. As the need for professional skepticism increases, so does the need for the discussion of fraud amongst the audit team. This results in an increased number of required meetings that involve both the partners of the firm and those assigned to the particular audit. Within these meetings, many topics are focused on, with those mainly being key ways to address fraudulent activities that may not have been looked at previously along with professional skepticism. The partners lead the meetings by talking about three parts of the triangle and how likely they think their clients will commit fraud. In other words, they must discuss any factors that may lead to any incentives or pressures, if the entity would feel inclined to rationalize, or any opportunities that could stem from the work environment, regardless of how ethical the client may seem.

Professional skepticism is also addressed in the meetings with the audit team and partners. Virtually, this requires the audit team to question the client even if their client has never disobeyed the law or caused any problems. Doing so is absolutely necessary because fraud can occur when you least expect it, from who you least expect it. If an audit team assumes that everything is reported truthfully, then there is a steeper risk of accounting fraud. When practicing professional skepticism, the client’s management team should be deeply observed because the elements of the fraud triangle could possibly shift their judgement in certain circumstances. For example, the CEO of a company can comply with all rules and regulations for a countless number of years, but can experience competitive pressures in the current year, tempting him or her to commit fraud. He or she might choose to force employees to enhance the company’s financial statements in order to give off the appearance that the company is exceeding all their
competition. The auditors can be quite surprised by the actions management takes to achieve this, but this is why they are told to be professionally skeptical.

One way to prevent the client’s management from enforcing accounting fraud upon their company is for the audit team to conduct meetings with them as well. However, this meeting must not include anyone from the client who is involved in the financial reporting process. The purpose of these sessions is to inform the client of their fraud risk assessment, meaning the perceived likeliness of the entity experiencing any type of fraudulent activity based on how they have reported in the past. From a broader perspective, the audit team is supposed to educate their client on the essence of fraud, how it is committed, the signs to look for, and how it can be prevented. The hope is that if the entity is fully aware of all of these aspects relating to accounting fraud, then they will be less prone to act out. At times, having a forensic accounting attend the meeting is a valuable idea. Forensic accountants work to catch illegal activities in the financial world. Specifically, they investigate fraud and prepare their findings for legal purposes, such as providing evidence in a courtroom. Casabona and Grego state that forensic accountants “provide an in-depth perspective of how and why a fraud may be perpetrated, and will raise the level of professional skepticism within the engagement team” (2003). Having the forensic accountant present can remind the client’s management team that accountant fraud can be detected and there is a rather systematic way to do it.

In addition to planning sessions with the client’s management and, occasionally forensic accountants, SAS No. 99 also directs the auditors to analyze the revenues produced on the client’s financial statements in order to gather evidence as to how the client calculated them. Although this is a typical formality of the audit process, the regulation requires the audit team to perform this in the planning stage. This will create a broad assessment of whether or not the
client possesses any material misstatement on their financial statements. As a result, it is simpler to catch any fraud if there is a warning that it may be present. When the auditors do this, they look further into the revenues and compare what the client has for the current year versus what they reported during the prior years. If the differences between these amounts are drastic, then it raises a red flag and notifies the auditor that the issue should be investigated further.

Another aspect of the financial statements that should be assessed in the planning stage should be the gross margins. A gross margin is calculated by subtracting the cost of goods sold, which is essentially how much it costs for the company to sell their goods, from the revenues. Auditors are responsible for knowing how these trends are supposed to move, or not move, and how to pinpoint a trend that might not look right. They can do this by looking back on the gross margins of previous years and, again, comparing them over time. A few other key categories to analyze via the financial statements are the client’s inventory, profitability, and accounts receivable turnover ratios. If anything seems atypical about these items, then they should also be addressed and be further investigated.

Improper revenue recognition is not always definite, purposeful fraud, but rather is a risk of fraud. Entities may honestly not realize that they did something wrong, which is why it is beneficial to assess this in the beginning stages. It is the duty of the auditor to investigate as to why this error in revenue recognition occurred and the best remedies to fix it. To do this, the team of auditors must understand their client and piece together the reasons behind their client’s actions. The team should not immediately give the client the benefit of the doubt due to the initiation of professional skepticism. However, the auditors should work to determine if it was simply a mistake or if there was motive and intent behind the error. Part of this investigation includes reaching out to the client’s customers and confirming that they received their end of the
bargain. In other words, it is to make certain that whatever obligation the client had to the customers was fulfilled. In accounting, revenue can be unearned, meaning that the customer will pay a company for a service or product before they actually receive it. Then, when the company provides the product or service to the customers, it may recognize it as earned revenue. So, the customers informing the auditors of whether or not they received what they were owed will help the team figure out what needs to be recognized and what cannot be recognized yet. This error is formally known as a material misstatement.

Risks of material misstatements should be carefully looked at throughout the duration of the audit. It is crucial for this to happen because the further they are examined, the better likeliness of the detection of fraud. If the auditor discovers there is definitely fraud present, then he or she should take certain precautions. Some of these include gathering evidence that proves the fraudulent activities, speaking with upper management and the client’s audit staff, and advising the client to get legal personnel involved. Often times, forcing the client to take legal action is not absolutely necessary if the fraud is not significantly impactful. In other words, if it is caught in a timely fashion, the auditor can assist the client with correcting it, if he or she chooses to do so. To do this, the client’s management department must exhibit full understanding and cooperation throughout the entire process. On the other hand, if the intended fraud is a large deal, then the auditor has the right to back out. Leaving the engagement can protect the auditor from being accused of involvement with the fraud. The sooner he or she relieves his or her duty, the better. The withdrawal from the audit is smoother when the auditor executes it in a professional manner. Management should be informed of the decision to leave and the reasons behind it.
Intended fraud not only drives away the auditors, but it also creates legal controversies that soon become public. When the fraud is exposed to the public, it typically coins the phrase “fraudulent scandal.” To date, one of the largest fraudulent scandals that has occurred is the Enron Scandal, which was revealed in 2001. This particular case “marked the biggest, fastest corporate collapse in American history” (Eichenwald et al, 2002). Before the downfall, Enron was extremely successful in the midst of George W. Bush’s election and inauguration. The company donated hundreds of thousands of dollars to President Bush’s campaign for one main reason. According to “Enron Buffed Image to a Shine Even as It Rotted from Within,” authors Kurt Eichenwald and Diana Henriques described Enron as, “a generous contributor to the Bush campaign” that “would use its White House access to advance its interests” (2002). Part of the reason why Enron generated such large profits was because the chief financial officer, Andrew Fastow, set up two separate partnerships as subsidiaries to Enron rather than separate entities. So, the money these two partnerships—known as LJM1 and LJM2—produced was tied to Enron’s profits, even though this was illegal. This is because Enron would do several transactions with Fastow’s partnerships. In Corporate Aftershock: The Public Policy Lessons from the Collapse of Enron and Other Major Corporations, Christopher Culp states, “As of June 1999, Enron had disclosed $34 billion in assets on its balance sheet, but another $51 billion in assets—many of which were troubled or impaired—lay hidden in Enron’s unconsolidated special purpose entities (SPEs)” (211). As Eichenwald and Henriques state, this strategy “decreases the company's risk by moving its holdings into separate partnerships that could be sold to outside investors more willing to assume those risks” (2002). Fastow had a “dual role” by being responsible for his partnerships and his career at Enron, so because of this, Enron’s top management was required to
monitor his activity within both. However, they failed and Enron gave off an appearance of being more profitable than it actually was.

Another reason for the company’s success and increased profits, which happens to be the most significant reason, is the fact that Enron recorded and accounted for the expected profits as the actual profits. As a result, these numbers were severely inflated, meaning that they were significantly larger than what they needed to be. Executives of the company would cut themselves checks because they assumed it was acceptable since the company was generating phenomenal profits. This was a huge problem because that money was simply not there to be distributed. An example of the ways in which Enron inflated their profits is that it would create an asset and instantly recorded the revenues it believed it would make off of that asset. Then, if the company generated less revenue than what was projected, it would not record the loss. When the loss failed to be recorded, Enron would simply write it off instead as an unprofitable activity. Enron figured it was able to do this because of its mark to market (MTM) accounting method. This method bases accounts on the fair value instead of their actual costs. Although the SEC approved of Enron utilizing this method in 1992, the company took advantage of it and abused their right to use it. Overall, Enron used the mark to market method of accounting in an overly aggressive and illegal manner. It can be noted, however, that Enron had an accounting firm working for it to oversee all financial activity.

Arthur Andersen LLP was the name of Enron’s outside accounting firm. At the time, Arthur Andersen was listed in the top five accounting firms in the country, mostly for its good standing along with its emphasis on high standards and superb risk management. After the scandal broke out, the accounting firm was brutally criticized for signing off on financial reports Enron had presented them with that should not have seemed correct at the time. There was never
any deeper investigation that resulted from the evaluation of the financial statements, which can be argued as an extreme irresponsibility for the accounting firm. It is the firm’s job to always be skeptical of the material being presented to them because this is a key way to detect fraud. The public was shocked that Arthur Andersen chose not to catch Enron in the act and stop the company at a sooner time because of their incredibly high, spotless reputation.

Enron’s downfall truly began when Jeffrey Skilling replaced Kenneth Lay as Enron Corporation’s chief executive. Prior to this change in position, events took place that certainly led to this downfall. Enron had been shifting its holdings into Andrew Fastow’s two partnerships so that the investors in these partnerships would assume the risks instead of Enron. This was illegal and the investors had no idea about any of it. Essentially, Lay was passing the mess along to Skilling, forcing him to face the critics now. Lay remained chairman, which was his other title within the corporation. Skilling was quite different from Lay, particularly in the way he desired to run Enron. Mostly, Skilling was more aggressive and competitive than Lay had ever been. When asked what Skilling’s main focus as chief executive was, Skilling simply replied, “to get the stock price up” (Eichenwald et al., 2002). Jeffrey Skilling was so hung up on this goal because to him, the price of Enron’s stock meant everything.

The reason as to why the stock price was so important to Mr. Skilling was rather understandable. Enron engaged in deals with Fastow’s partnerships and financed the deals through Enron’s stock. Now, Enron needed these partnerships to hide its money in, so if Enron’s stock prices plummeted, then the partnerships would not be provided with adequate investments. Enron enacted triggers, which held Enron accountable to their stock prices. To continue to finance with its stock the stock prices were required to remain high enough. If not, Enron would have no other choice but to decrease its reported profits. Using the same strategy as using the
partnerships, Enron formed entities known as the “Raptors” that also secretly kept Enron’s earnings away from harm. Another attribute the Raptors had in common with the Fastow partnerships was the fact that they were also funded through Enron’s stock. So, if stock prices took a nose-dive, then both of Fastow’s partnerships, along with the Raptors, would struggle to survive.

Soon, the inevitable started to happen and the Raptors were in danger of going belly-up. This happened as a result of a major decrease in Enron’s stock price. Another reason was, “they had already paid out more than $160 million to Mr. Fastow's LJM partnerships, whose investors included Merrill Lynch, J. P. Morgan Chase, Citigroup, the MacArthur Foundation and the Arkansas Teacher Retirement System” (Eichenwald et al, 2002). It was going to take some serious strategizing and unwavering efforts to get the Raptors back up to where they needed to be. Miraculously, at the end of Enron’s reporting period, employees of the company somehow made this happen and the Raptors passed the essential accounting tests. This meant that Enron did not need to report any losses for this particular period. Skilling was exceptionally pleased about this. In their article “Enron Buffed Image to a Shine Even as It Rotted from Within,” Eichenwald and Henrique claim that, according to senior employees at Enron, Skilling was “intensely interested” in fixing the Raptors’ problems and made it “one of the company’s highest priorities” (2002). The accountants at Enron fixed the Raptors for the time being.

Shortly after the Raptors scare, Enron made a deal with a company known as Chewco. Chewco was a partnership that was related to Enron through another partnership called JEDI. According to Eichenwald and Henrique, “Chewco owned a stake in yet a third Enron-linked partnership, called JEDI, and wanted to sell that stake to Enron” (2002). Ironically, a man named Michael Kopper, who happened to work for Enron’s Andrew Fastow, controlled Chewco.
Resultantly, Enron was exceedingly intertwined with these partnerships. When Enron purchased the stake from Chewco, it paid thirty-five million dollars, and everything officially stayed within the company. These transactions are illegal because with Enron being involved in every piece of it, there was a motive to complete the deal so that it would solely benefit those involved. Additionally, according to Keith Bockus, Dana Northcut, and Mark Zmijewski, “Chewco should have been subject to full consolidation” (199). This is because Chewco was “failing to satisfy the nonconsolidation principles of EITF D-14 and 90-15 that required that an independent third party have a substantial investment in the SPE, control of the SPE, and derive significant risks and rewards of ownership of the SPE’s assets” (Bockus et al., 199). As a result, “because Enron did not account for Chewco as such, the $383 million in unsecured debt remained off Enron’s books, as did the $383 million investment in JEDI until the restatements in 2001” (Bockus et al., 199). This was a massive count of accounting fraud that Enron was conducting.

Enron was also in the wrong because it did not relay any information to its shareholders. Due to the fact that the shareholders own part of the company, they possess the right to know what is happening financially. In other words, Enron should have had some level of transparency with its shareholders rather than keeping them in the dark about the things going on behind closed doors. These people who purchase a company’s stock are extremely important to the company. Due to their part ownership of the company they purchase stock in, it is crucial that information gets disclosed to them.

Not everything was hidden from shareholders, however. On April 17, Enron announced its outstanding progress via its first quarter earnings of four hundred and twenty-five million dollars. Since the company was dominating the business world, analysts from Wall Street requested a phone call interview from Enron’s executives. One of these analysts, named Richard
Grubman, had always been a skeptic of Enron and its practices. As a matter of fact, Grubman “had made investments that would have allowed him to profit if the stock declined” (Eichenwald et al., 2002). So, during the interview, he was not shy when it came to questioning Enron. Interestingly, he asked the executives why the balance sheet was released at a later time than when they announced their profits. When Skilling assured that it was strictly company policy for not releasing them at the same time, Grubman bluntly replied, “You're the only financial institution that can't produce a balance sheet or a cash flow statement with their earnings” (Eichenwald et al., 2002). This was extremely eye-opening. In accounting, a balance sheet reflects a company’s assets, liabilities, and owner’s equity. Assets are what the company owns, liabilities are what the company owes, and owner’s equity is what is left for the owners after the assets and liabilities are accounted for. Balance sheets can be produced at any time of any day during the year, unlike income statements that can only be produced at the end of a period. So, this is the reason why it was awfully fishy that Enron was unable to show its balance sheet in a timely manner.

Enron’s unwillingness to disclose the balance sheet at the same time as its other financial statements was not the sole indicator of the wrongfulness that was occurring within the company. In October of 2000, a lawyer named Jordan Mintz, who worked in Enron’s headquarters, uncovered some documents regarding Fastow’s two partnerships. Quickly, he discovered that these partnerships had been run by Fastow, and Skilling was doing business with his employee. After noticing that Skilling had neglected to sign some of the documents, Mintz reached out to him in hopes of some type of explanation. Skilling refused to respond, so Jordan Mintz had no other option than to turn to Enron’s other superiors. The Chief Accounting Officer and the Chief
Risk Officer both ensured Mintz that there was nothing to worry about and advised him to leave Skilling alone. Little did anyone know that Enron would begin failing very soon.

The stock price had always kept Enron afloat, regardless of what events took place both outside and within the company. When the stock price severely plummeted on July 23, Skilling descended into panic mode. This alone drove him to resign as Chief Executive of Enron on August 14—not even a month after the stock price significantly decreased. As a result, Kenneth Lay filled the role of Chief Executive once again. Shortly after this took place, Lay received a letter from Sherron Watkins, one of Fastow’s employees who was assigned to work on his partnerships. She was fully aware of everything that was going on regarding the partnerships and chose to finally voice her concerns to Lay. When talking about the partnerships, Watkins communicated to Lay that, “I am incredibly nervous that we will implode in a wave of accounting scandals” (Eichenwald et al., 2002). Although the executives of Enron assumed that none of the employees were aware of what was going on behind their backs, some ended up putting the pieces together and discovering it on their own.

Ken Lay felt inclined to take all necessary precautions for Enron once employees began uncovering the company’s issues. So, Lay made the executive decision to hire an outside accounting firm—Vinson and Elkins. He preferred that Arthur Andersen, Enron’s designated accounting firm, not conduct the investigations because if it had not caught anything up to date, then there was a likely chance it was not going to speak up at this point. However, Vinson and Elkins was the law firm that partly did some work for Fastow’s partnerships. As can be predicted, the firm did not pinpoint any problems about Enron’s financial statements. This is most likely because the accountants at the firm chose to turn their heads and act like nothing was wrong when clearly, some numbers did not add up. If Enron failed, then they would lose
clients—the two partnerships owned by Fastow. After Vinson and Elkins’ assessment of the company, the firm assured Ken Lay and James Derrick, Enron’s general counsel, that everything was “on the level” (Eichenwald et al., 2002). This meant that the law firm missed Enron’s wrongdoings, either by choice or by mistake. The firm was linked to Enron, so it was extremely likely that its obliviousness was by choice.

Kenneth Lay believed Vinson and Elkins and proceeded to inform his employees that Enron was in recovery mode. He told them that although Enron’s stock price was extremely low, it would soon increase again. The employees counted on Lay because their retirement funds depended on the success of Enron’s stock. Unfortunately, the employees had every right to be worried. Auditors from Arthur Andersen—the main accounting firm that had been auditing Enron for years—realized a mistake they had made regarding the partnerships. The problem had to deal with the way the stock was accounted for that was being used to finance the Raptors, which was misappropriated by a whopping one billion dollars. As a result, Enron’s assets showed that they were one billion dollars greater than they actually were and fixing this issue would cost Enron this amount. This was the beginning of Enron’s massive downward spiral.

All of Enron’s employees—even the ones who were completely innocent—were stuck in this mess. Not only was this scandal likely to put them out of their jobs, but they were also not permitted to sell their shares of stock for thirty days, per Ken Lay’s command. This was a serious disadvantage to the employees because the stock prices continued to decrease drastically on a daily basis. The not-so-innocent employees were not only in trouble financially, but also legally. The Securities and Exchange Commission began investigating Enron and Andrew Fastow, the mastermind behind the partnerships, was fired from the company the same day (Segal, 2018). Then, Enron’s cumulative losses were revealed, coming to a total of $591 million. In addition,
the company suffered from $628 million in debt (Segal, 2018). To make the situation worse, these intense losses would directly affect the shareholders of Enron.

As a desperate attempt to save Enron, Mr. Lay reached out to a formal rival company about a possible merger. This company was known as Dynegy, Inc. and had been a competitor of Enron for several years. Even after disclosing the problems occurring at Enron, the president of Dynegy was on board to merge with the failing company. However, the only way the two companies could merge, per requests of Dynegy’s president, was if Ken Lay stepped down after the merger took place. This was the very last thing that could have saved Enron, although the chances it would actually be revived were extremely slim. At this point, the company was extremely unfixable. Too much fraud had been committed and it was inevitable that Enron would need to account for some fairly extreme losses that would bring them down regardless of whether or not the merger took place.

To Lay’s surprise, Dynegy made the sensible decision to back out of the merger. Enron’s executives had lied to those of Dynegy and pretended as if the reason for the drop in Enron’s stock price was because of the hiccup in the stock market. Lay and his colleagues assured Chuck Watson, Dynegy’s Chief Executive, that all of Enron’s businesses were doing well and that absolutely nothing was wrong within them. However, that was undoubtably not the case. Once Watson discovered the lies that were hidden beneath the surface, he pulled the plug on the deal. Enron was officially on its own. As hard as the company tried, Lay sadly realized there was nothing else to do and no further actions to take, other than one—filing for bankruptcy. On the second day of December, a paralegal from Weil, Gotshal named Steven Vacek filed Enron’s bankruptcy petition (Eichenwald et al., 2002). This would soon break the economy and wreck many peoples’ lives.
Shareholders are typically significantly invested in publicly-traded companies. Large corporations often offer stock options to its employees, meaning that the employees can purchase company stock for a set price and sell them after a certain period of time. These options can be extremely beneficial to a company’s employees if the company does fairly well in the stock market. In other words, if an employee purchases stock for a set amount and then the price of the stock increases in the stock market, employees can make money from selling their shares when the price is high. However, if the stock price in the market plummets, then the employees must either wait until the price increases again or sell and lose money. This is exactly what happened to the employees of Enron after the fraud scandal leaked. Everyone who had exercised stock options in Enron lost large sums of money, most of it being their retirement funds and, in some cases, life savings. You may wonder why people are often drawn to invest almost everything they have into one company, but it is more likely than one may think.

The appeal of purchasing a company’s stock stems from the current success of the company. If a company is leading the stock market—or close to it—and is talked about greatly, then people feel as if they need to invest in the company. The higher the popularity and success of a company, the higher its stock price increases in the stock market. If the company continues to achieve more as time goes on, then investors will want to purchase its stock as soon as possible in hopes that the stock price will continue to increase after they have acquired it. A prime example of this is the situation pertaining to Enron. At one point, Enron was in all the headlines for being the top corporation in all economic aspects. Ironically, Enron ended up being in the news in the best and worst ways. However, at its peak, Enron was the sole company that the majority of investors wished to purchase stock in. It trumped most companies in profits and most investors figured they could buy stock, allow the price to continue to increase, and then sell
for a profit. Since the price of the stock rarely ever decreased in the stock market, everyone put their trust in Enron to help them make some money. This strategy, however, was too good to be true. Most investors who put their money into Enron lost most—if not all—of it. Many wondered how, and why, Enron could do this to its shareholders, and although it was not the motive to put the shareholders at such a disadvantage, the company could have easily prevented this brutal outcome. Many factors played a role in this end result.

Company culture was a massive driving force behind why Enron committed the accounting fraud. A company’s culture refers to the environment in which the employees work and encompasses its values and beliefs. At Enron, the executives wanted to make certain that the company stood apart from other companies by being the absolute best. Since this was the goal, the company chose not to exercise honesty. Resultantly, this means that Enron’s culture was not just and had several loopholes within it. Employees were granted permission to do whatever it took to make Enron shine and sadly, this involved fraudulent actions. The people holding higher positions in the company became greedy because they longed to keep their reputations pristine as the most successful executives in the country. Surprisingly, people will go to great lengths to portray an image of greatness, even if it includes breaking the law. Clearly, to these particular people, the often short-lived great reputations outweigh the brutal consequences of getting caught. Setting the culture to be this way can put pressure on a company’s employees and force them to feel obligated to follow the unjustness, or else they risk losing their jobs. As leaders, executives should do everything in their power to create a culture that is effective, but honest.

Not only is it the responsibility of the senior executives to set the right standards for their employees, but this responsibility also falls onto the directors of a company. In Enron’s case, the board of directors were blindsided by the multiple entities Enron developed but did not account
for on its books, but this happened to be their own fault. They did not fulfill their duties as the company’s directors, which caused them to miss several red flags that should have been caught. Unfortunately, the directors also failed to look out for their employees and only focused their attention on Enron’s shareholders. The shareholders should always be a priority, but in order for a company to excel, the employees must have the right tools and support to perform. Ultimately, to create happiness among the shareholders, employees must also be happy. However, Enron had a gray area regarding this theory—a large portion of the employees were also shareholders in the company. So, Enron’s board of directors let both the employees and the shareholders down.

Skilling, Lay, and Fastow were the three masterminds behind Enron’s dishonest success. They were the ones who made the decisions to keep Enron’s entities off the books and manipulated the company’s profits. Enron’s portrayed success was the main reason as to why nobody questioned the executives. When the stock prices continue to rise and dominate the stock market, both the leaders and shareholders of the company are content and are less likely to investigate the reasons behind the increase. The way a company makes money can be a good indicator of the strength of its compliance with rules and regulations. If it generates profits very rapidly, then questions should be raised as to why this is happening. This growth can absolutely be legitimate, but companies need to prove it. If they are unable to do so, then the operation must be terminated immediately and shareholders must be informed. Enron’s fraudulent practices were not shut down because nobody second guessed what the company was doing. Most figured that since Enron had a reputable accounting firm checking its business engagements and activity, everything the company was doing was correct and truthful. In fact, most analysts—people who study the economy and stock market—strongly recommended that people invest in Enron
because of its spike in economic success. Only few analysts were skeptical and attempted to convince investors to do differently.

When Jeffrey Skilling took over for Kenneth Lay, he approved a breach in the company’s code of conduct. In other words, Skilling made an exception for allowing the executives to override the company’s policy on intervening with entities related to Enron. In this case, the two entities were owned by one of Enron’s executives. Not only was Andrew Fastow—creator of the two partnerships—an executive, but he was the Chief Financial Officer. There was little superiority watching over Fastow’s actions. Richard Causey, Enron’s Chief Accounting Officer, and Richard Buy, Enron’s Chief Risk Officer, were ordered to watch the activity between Enron and the two partnerships. Causey and Buy failed to carry out their duties, which then drove Fastow to continue transferring Enron’s holdings into the two partnerships—LJM1 and LJM2. As a result, it gave off an illusion that Enron’s profits were on the rise. As mentioned previously, this is why Enron experienced its downfall. Many factors made up the consequences of this accounting fraud scandal, which is still known as one of the most impactful cases of fraud to date.

The negative impact of the Enron Scandal drove Congress to write and pass a law that would reduce, if not eliminate entirely, instances of companies committing accounting fraud. This new law was formally known as the Sarbanes-Oxley Act of 2002 and is still in effect to this day. The Sarbanes-Oxley Act—also called SOX in short—was passed by Congress and signed by President George Bush in 2002. Knowing that many investors suffered from the Enron downfall, Congress informed the public that the purpose of the Act was to create “dramatic change across the corporate landscape to re-establish investor confidence in the integrity of corporate disclosures and financial reporting” (Donaldson). Furthermore, the Act “provided
welcome new enforcement tools to combat corporate fraud, punish corporate wrongdoers and
deter fraud with the threat of stiffer penalties” (Donaldson). Donaldson then goes on to describe
the next portion of the Act, explaining that Congress had “increasingly designed strategies that
take advantage of the creative provisions of the Act to return funds to investors who have
suffered losses rather than merely collect those funds for the government.”

The main objectives of the Sarbanes-Oxley Act are as follows: to strengthen and restore
confidence in the accounting profession, strengthen enforcement of the federal securities laws,
improve the "tone at the top" and executive responsibility, improve disclosure and financial
reporting, and improve the performance of "gatekeepers." Several categories fall under the
“strengthen and restore confidence in the accounting profession” category. The first category is
the establishment of the Public Company Accounting Oversight Board, otherwise known as the
PCAOB. Although the Public Company Accounting Oversight Board will be discussed in greater
depth later on, the main mission of the Board is to oversee public accounting companies and
issue regulations in order to keep the companies honest. The PCAOB has done wonders for the
accounting profession and, again, will be discussed later on.

The second portion regarding strengthening and restoring confidence in the accounting
profession is auditor independence. This ability to be independent is extremely notable in the
accounting profession because accountants must do everything objectively. If there are any ties
to the entity they are auditing, then it might severely affect the results. Secondly, auditors should
be trusted to do honest work on their own. A lack of auditor independence had been prevalent in
the Enron Scandal, so some provisions had to be made to this category. They were as follows:
“expand the non-audit services that, if provided to an audit client, impair an auditor's
independence, require an issuer's audit committee to pre-approve all audit and non-audit services
provided to the issuer by the auditor, require that certain partners on the audit engagement team rotate off the engagement after either five or seven years depending on the partner's role in the audit, establish a "cooling off" period between participation on the team auditing an issuer's financial statements and assuming certain functions as a member of that issuer's management, require the auditor to report certain matters to the issuer's audit committee, and require certain disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor” (Donaldson). These alterations were aimed at providing the auditor with a more stable structure of independence.

Another part that pertains to strengthening and restoring confidence in the accounting profession is recognition of the Financial Accounting Standards Board. Under this change, all auditors must ascertain their clients are following the Generally Accepted Accounting Principles, or GAAP. If their clients disobey this requirement, then auditors need to be able to catch it and address the issue. So, in order to possess the ability to search for the use of GAAP, it is imperative that accountants are remarkably familiar with all GAAP principles and know how to use them properly.

Next, we move onto the second main objective of the Sarbanes-Oxley Act, which is to strengthen the enforcement of the federal securities laws. One of the largest aspects of this objective was the establishment of reporting directly to Congress. These reports must be made by the Securities and Exchange Commission, but it opened the door to an easier way of reporting any fraudulent evidence. When Congress put this part into effect, it hoped that it would improve enforcement efforts and the assisting of investors who had been victims of fraud. Financially helping these investors was a new addition to the Fair Funds provision, where the Securities and Exchange Commission had permission “to use penalty moneys for distribution to investors even
if no disgorgement is ordered” (Donaldson). All in all, this objective was established to build the actions needed to be taken after any fraud occurs.

One of the most significant objectives of the Sarbanes-Oxley Act is to improve the “tone at the top” and executive responsibility. According to Donaldson, “the tone set by top management is the most important factor contributing to the integrity of the financial reporting process.” This goes back to the previous discussion on internal control and how crucial that element is to companies. Under the Sarbanes-Oxley Act, senior executives, such as the CEO and the CFO, are responsible for reporting fair financial statements. If these statements are falsified or fraudulent, the senior executives must take full blame. To ensure fraud does not occur, companies must have set disclosure controls and procedures. Furthermore, companies should be able to maintain them and assess their effectiveness. If the controls are too weak, then changes should be made to them. Another requirement under this objective is to hold “a reporting company to disclose annually whether the company has adopted a code of ethics for the company’s principal executive officer and senior financial officers” (Donaldson). Company culture is a significant part of internal control, too, and should be focused on. For example, PepsiCo issues a survey to the senior executives of the company to obtain their input on the company’s culture and how it could be improved. In addition, PepsiCo hosts an annual ethics training to assess their employees’ awareness of protocol and their responsibilities (Dittmar et al.). When efforts like these are made, then there is a better chance that internal control will be strong.

When Sarbanes-Oxley was first put into effect, several companies and firms believed all the new protocols were overwhelming. The first year it was passed, accounting professionals scrambled to update company manuals, policies, and control processes. After the alterations took
place and all paperwork was up to standard, executives and the management of entities began to show a liking for the Sarbanes-Oxley Act and all that it had to offer. Not only did the improvements help companies run more smoothly, but it also provided the employees with a better understanding of their own company’s system of controls. Additionally, the audit committees of organizations formed a tighter, stricter design that increased the effectiveness of their audits. Overall, the benefits outweighed the drawbacks of the Sarbanes-Oxley Act.

Improving disclosure and financial reporting is another key objective mandated under the Sarbanes-Oxley Act of 2002. The general purpose behind this is to assure the shareholders that the financial statements being presented to them are factual and reliable. Information provided in a company’s financial statements is the root of an investor’s decision-making process. Keeping investors’ trust stable is necessary because the more they purchase stock, the more the economy is stimulated. With this being said, the Act stated that companies now had to evaluate their internal control and file a formal report about it. More specifically, “the Act requires the auditor of the company's financial statements to attest to, and report on, management's assessment of the company's internal control over financial reporting in accordance with standards established by the Public Company Accounting Oversight Board” (Donaldson). Reporting of off-balance sheet transactions was now also obligatory with the new Act.

The final goal of the Sarbanes-Oxley Act is to improve the performance of gatekeepers, or auditors. Under this objective, audit committees are expected to comply with the implemented standards specifically directed at committees. These standards do not only apply to audit committees in the United States, but they are also effective in foreign countries. Since the United States conducts regular business with outside countries, it is important for auditors to be able to follow one set of standards when auditing the transactions. This is listed in Section 301 of the
Act. One more crucial piece of this Act’s objective is to force attorneys to report any suspicious activity they find to an audit committee or a board of directors that happen to be involved with the activity. Having a set system of reporting for auditors and attorneys guides them in the direction of properly uncovering fraud. The largest provision in the Sarbanes-Oxley Act, however, was the omission of any references to the Generally Accepted Accounting Principles. Now, this did not eliminate GAAP from accounting practices, but Congress wanted companies to have to meet a standard that was broader than the financial reporting requirements under GAAP (Mixter).

Auditors were not permitted to refer to the Generally Accepted Accounting Principles under the Sarbanes-Oxley Act of 2002. This was set in motion after a case known as United States v. Simon (1969) took place. Three auditors had failed to disclose millions of dollars’ worth of loans receivable as being uncollectible in this case. Harold Roth, who was one of the auditors, could not pay off the money he was loaned and attempted to offset it with an amount receivable he was owed. When the amount receivable became uncollectible, Roth only stated two-thirds of the collateral in his business’ financial statements. The auditors of the business claimed that this was not inconsistent with either GAAP nor the Generally Accepted Auditing Standards, otherwise known as GAAS. When taken to court, the Ninth Circuit said, “Simon recognized that compliance with [GAAP] would not immunize an accountant when he consciously chose not to disclose on a financial statement a known material fact” (Mixter). Therefore, GAAP should not govern. This is why the elimination of any references to GAAP took place. It ended up being a substantial portion of the Sarbanes-Oxley Act.

The Sarbanes-Oxley Act of 2002 was formed in the wake of the Enron Scandal, but that was not the only matter that evolved from it. Though Sarbanes-Oxley produced a positive
outcome regarding the prevention of accounting fraud, its intentions were misread at times. For example, when the Act was put into effect, the world assumed that it was strictly to prevent accounting fraud from occurring. However, the scope of the Act went much further beyond the accounting field in general. In 2011, a case called *Yates v. United States (2011)* involved a fisherman by the name of John L. Yates who was convicted of destroying evidence in the midst of a federal criminal case. Yet, it was not a pile of documents or any hard drives he was destroying. Rather, Yates was destroying fish. It all began when his boat was subjected to a routine inspection. Federal law stated that groupers had to be at least twenty inches in length and if they failed to meet this requirement, then they were required to be freed back into the water. Yates’ fish did not meet the size requirement, so the agent that conducted the inspection demanded him to return to the dock. Since he was in danger of having to pay fines and receiving a suspension on his fishing license, Yates decided to destroy the evidence and replace those fish with new, larger ones. After he was caught, he was charged under Section 1519 of the Sarbanes-Oxley Act of 2002 (Walsh).

Section 1519 of the Sarbanes-Oxley Act states that it is illegal to destroy any evidence of a case. Attached to this Section is a provision known as the Anti-Shredding Provision which aims to “prosecute the destruction of a wide array of physical evidence—including human bodies, bloodstains, guns, drugs, cash and automobiles—in order to cover up offenses ranging from terrorism and the unreasonable use of lethal police force to violations of environmental and workplace-safety laws” (Walsh). In fact, Section 1519 was used to prosecute the perpetrator of the Boston Marathon bombing. So, as can be seen, the Act was taken very seriously after the Enron Scandal and was not limited only to the prosecution of those committing accounting fraud.
However, the severity of the Enron Scandal was the driving force behind the seriousness of the Act.

An addition to the Sarbanes-Oxley Act was made in 2003 in the wake of corporate fraud cases, such as the Enron Scandal. This new part was the establishment of the Public Company Accounting Oversight Board, otherwise known as the PCAOB. The board was created to regulate audit-independence issues and to essentially oversee auditors. Douglas R. Carmichael was named the chief auditor of the PCAOB at the time and was responsible for overseeing any alterations to the nation’s auditing standards. He, along with the rest of the Public Company Accounting Oversight Board, had a crucial job in the midst of the multiple corporate scandals that had occurred. As a result of these cases, many auditing standards were reformed and the PCAOB was in charge of this. Douglas Carmichael was the creator of a rule that eliminated a handful of tax services that could be provided by auditors. He did this because, in the past, accounting firms would secretly sell tax shelters to audit clients and their executives (Fraser, 28). Activities like these are extremely illegal and punishable. This was only one example of how the Public Company Accounting Oversight Board had to develop ways in which auditors could identify fraud before its occurrence.

The Public Company Accounting Oversight Board is seen as being prestigious, honorable, and trustworthy. It is necessary for its employees to be honest because they are held at a high standard. A case broke out this year, 2018, involving former KPMG executives and Public Company Accounting Oversight Board employees who attempted to defraud the Securities and Exchange Commission by illegally utilizing confidential lists which stated the specific KPMG audits that the PCAOB would be reviewing. This gave KPMG the ability to perfect the chosen audits in order to obtain an outstanding report, which an illegal and fraudulent activity.
Accounting firms were, and still are to this day, never allowed to receive warning on the material they will be audited on. The Big Four firm had been doing quite poorly with its previous PCAOB inspections, so three of its executives made the decision to take extraordinary measures to ensure they had a successful inspection. These three executives lured in the PCAOB employees, who happened to be former KPMG employees, by telling them to be loyal to KPMG. Then, they proceeded to encourage the former employees to retrieve the confidential audit lists. When these actions surfaced in the public eye and investigations began, the executives of KPMG attempted to destroy the evidence. Hoping to leave no trace, they deleted what they could—text messages, emails, and documents. Be that as it may, they were still caught in the act.

The fraudulent scam between the three KPMG executives and the PCAOB employees began in 2015 when Brian Sweet, former PCAOB Associate Director of Inspections, was hired by KPMG. Allegedly, the firm made it a priority to hire Sweet. Brian Sweet was not the only former PCAOB employee to be hired by KPMG. The other candidate’s name was Cynthia Holder, and she had lied to the PCAOB about accepting a job at KPMG in order to retrieve the confidential data about the Public Company Accounting Oversight Board’s inspection plans. After the emergence of their actions took place, six individuals were arrested and planned on going to court to prove their innocence. David Middendorf and David Britt, both employees of KPMG, denied their allegations. Brian Sweet was the sole individual to plead guilty to conspiring to defraud the United States government and wire-fraud conspiracy. Luckily, he agreed to settle with the Securities and Exchange Commission.

KPMG had always been a very reputable firm, especially because they were, and still are, one of the “Big Four” accounting firms. When a handful of KPMG’s employees chose to commit fraud, it was a complete shock to outsiders and fellow employees within the firm. One advantage
KPMG has is its whistleblowing hotline called FairCall. Essentially, FairCall is an ethics service line that employees can call to raise concerns about possible fraudulent activities that may be occurring within the company. The ultimate goal of this hotline is to provide employees with a confidential platform to speak up. Another part of this goal is to preserve the firm’s reputation by detecting any fraud and suspicious activity early on. After an employee makes a call using this line, someone within the organization will be notified with the report within the first twenty-four hours. From that point on, further investigation will take place. Currently, FairCall is being used all around the world in places such as the United Kingdom, Australia, Africa, and Korea. This is because KPMG is a global firm. Having the FairCall line for employees can be seen as a strong part of the firm’s internal control. Fraud occurs more often than people may think, so it is essential to have ways to combat it. Some firms are not as fortunate to have resources in place like this.

Based on cases from the past, an ethics hotline in all companies could have been extremely useful. For example, another notably significant fraudulent scandal involved Bernie Madoff and his company at the time—Bernard L. Madoff Investment Securities LLC. Occurring in 2008, this case happens to be one of the most recent. The gist of this case consists of Madoff running a separate advisory business apart from his securities company and illegally using his new clients’ money to pay other clients who wanted to cash out. Instead of accepting investors’ money for business purposes, Madoff opened a personal bank account at Chase Manhattan Bank—which later became JPMorgan Chase & Co.—and allowed the money to sit until it was time to pay a client who desired to cash out. Individuals and companies were drawn to his company partly because Madoff developed an exclusivity perception, meaning that he turned down potential clients to make it seem as if his allowance for someone to invest in his company
was a significant deal (Floyd). This strategy also created a legitimate sense of the way the business was run. If he refused to grant access to the entire public, then people would strike it as a rather organized operation. Plus, his pickiness drove in larger clients, such as actor Kevin Bacon and New York Mets owner Fred Wilpon. Like any typical investment cycle, people reached a point where they wanted to cash out and possibly put their money different companies.

After the investors began to redeem their balances, Madoff was unable to fulfill all of the requests. His funds were depleted quickly, and he soon realized that he physically could not pay all of his investors back at their promised amounts. Madoff would periodically send out statements to his clients that included their account balances, which happened to be fake numbers. The clients were completely unaware and trusted that the amounts were legitimate. In addition, he falsely reported the company’s financial standing to the Securities and Exchange Commission. The Securities and Exchange Commission—also known as the SEC—received several complaints regarding the supposed illegal activity within Bernard L. Madoff Investment Securities LLC but denied any presented speculation.

The truth began to emerge about the workings as some attempted to cry out to the SEC. In 2005, Harry Markopolos, a Certified Financial Analyst, was one of these people as he wrote a panicked letter to the SEC. Within his writings, he warned the SEC, “Madoff Securities is the world’s largest Ponzi Scheme” (Floyd). In fact, these letters began in 2000 and carried on through 2005—a full five years of warning. One of the biggest red flags that was raised was the fact that Madoff’s returns to his clients remained extremely consistent, regardless of how the stock market was doing. For example, Madoff invested in the S&P 500, which is essentially the average performance of the top five hundred publicly traded companies. As the S&P started to fall in the stock market, Madoff’s returns to his investors remained stagnant. This is highly
impossible because as far as trends go, if the initial investment goes down, then the other investments that are directly impacted from it must also decrease. More often than not, they move in the same direction. Markopolos had been studying Madoff over the years, since 1999 to be exact, and had desperately been trying to get through to the SEC. The organization continued to deny his accusations for years. As his final attempt in 2005, in the letter he drafted to the SEC, he wrote, “There is no SEC reward payment due to the whistle-blower so basically I am turning this case in because it is the right thing to do” (Floyd). At this point, Markopolos wanted nothing more than justice for Madoff’s affected lenders.

Madoff’s plan began to fail, and he realized that it was not possible to go on with these activities. On December 10, 2008, Bernie Madoff came clean to his two sons, Mark and Andy. After the confession, his sons had no other choice than to report their father to the authorities. Sadly, Madoff claimed he never saw his sons again after that day. To say his family—and eventually the rest of the world—was shocked would be an understatement. The aftershock of the scandal was so intense that Madoff’s son, Mark Madoff, committed suicide only a couple years after the fraud surfaced. Along with his son, many of Madoff’s investors also ended their lives because the consequences were too powerful. A few years later, cancer took Bernie Madoff’s other son, Andy. Bernie Madoff went from being on top of the world to being brutally crushed by it.

Several legal actions were taken against Bernie Madoff after he admitted to the fraud he committed for many years. In “The Bernie Madoff Story,” David Floyd describes Madoff’s punishments, saying he “was sentenced to 150 years in prison and forced to forfeit $170 billion in 2009.” In addition, his most valuable possessions, such as his yacht, were taken away by the government. As previously mentioned, not only were his personal assets seized, but also those of
his business. The ultimate goal was to make sure he was left with nothing because of all the harm
he had caused. Madoff swore he acted alone, but others involved were also imprisoned.

Not only did the perpetrators of the actual fraud get punished, but the accountants dealing
with Madoff’s firm also got interrogated. The firm had hired a small accounting firm, known as
Friehling & Horowitz, to audit its financial activities. Friehling & Horowitz had one active
accountant—David Friehling. This accounting firm was supposed to be registered with the
Public Company Accounting Oversight Board because one of the clients it audited, which was
Bernie Madoff’s firm, was a brokerage firm. Friehling & Horowitz was also required to be peer
reviewed, meaning that it was also supposed to be audited to confirm that it was performing its
audits correctly. Typically, the larger accounting firms would be in charge of doing this, such as
the Big Four. In fact, Klynveld Peat Marwick Goerdeler—more commonly known as KPMG—
faced accusations of neglecting to discover the fraud that was occurring within Bernard L.
Madoff Investment Securities LLC. When this Big Four firm was confronted with these claims,
its spokesperson immediately came forward and said, “our audit conformed to all professional
standards” (Dugan et al.). KPMG’s main argument was that the only responsibility that they
were required to fulfill was to make sure that its clients’ numbers added up. In other words, it
was not up to KPMG to detect any fraud.

KPMG’s claim that it was not their job to look for any fraud evolving from the presented
financial statements of the brokerage firm almost contradicts what it does as a firm. All
accounting firms—regardless of whether they are small, mid-size, or large—must carry out the
same duties and responsibilities. Certified public accountants are seen as being one of the most
trustworthy, honest professionals and there are reasons as to why they are viewed this way.
Accountants are trained to evaluate statements and items objectively and provide their honest
professional opinions to their clients. Although that specific job to ensure there is no fraud present might not have been clearly stated, it still should have been assumed. For a firm like KPMG with great experience and a well-established name, its accountants needed to be more on top of the detection of fraud.

Another accounting firm was intertwined with the Bernie Madoff accounting scandal. This small firm went by the name of Sosnik Bell & Co. and provided broad services to its clients. The firm, run by Scott Sosnik and Larry Bell, “compiled profits, losses and gains and prepared tax-summary statements and schedules to be used by a client's regular accountant for income tax returns” (Dugan et al.). Madoff referred his clients to use this firm for all their accounting needs. So, most of Madoff’s clients were also clients of Sosnik Bell & Co. The firm’s reasonable price and trust in Madoff lured the clients in. Unfortunately, this small accounting firm was blindsided by Madoff and his schemes. When the horrible news broke out that Madoff was running a fraudulent business, Sosnik and Bell assured their clients that they had no knowledge of Madoff’s wrongdoings. They, too, had “personally lost millions of dollars in Madoff investments” (Dugan et al.).

The Bernie Madoff fraud case had a lasting impact on many lives. Numerous people entrusted their life savings with Madoff. Not only did individuals get shorted, but so did nonprofit organizations and other businesses that could not necessarily afford to lose those funds. In total, sixty-five thousand people came forward with claims that they were affected. The victims were from over one hundred countries, which truly highlights how widespread Madoff’s scandal was. A fund, known as the Madoff Victim fund, was founded in hopes to replenish most of the investors’ money they contributed. Direct victims received priority, while indirect victims did not. The difference between direct victims and indirect victims is based on the amount lost.
within the fraud. Direct victims lost money by investing a greater amount than they received, unlike indirect victims whose initial money was returned to them. When developed, the goal of the Madoff Victim Fund was to provide financial compensation and justice to those affected.

The Madoff Victim Fund is still in effect today. In fact, on April 18, 2018, an announcement was made that the victims of the Bernie Madoff Ponzi Scheme were going to receive $504 million dollars more in payouts from Madoff’s seized assets through the Madoff Victim Fund. This seems like an enormous sum of money, but it is only a sliver of the overall amount victims lost through this fraud case. There is no doubt that this money will help the victims, however. In her New York Times article “Victims of Bernard Madoff’s Ponzi Scheme to Receive Millions More,” Katie Benner says, “With this distribution, the second in a series of payouts, about 21,000 victims will have received a total of more than $1.2 billion, the Justice Department said.” These efforts can get a bit tricky, though, because everyone assumed there was more in the business than what there actually was. Since Madoff lied about these amounts, the government can only distribute the “real” money and assets from the business, not the fictitiously-reported assets. Irving Picard, who is a court-appointed trustee, began breaking down the assets of Madoff’s firm as soon as Madoff was arrested. Strictly from the business, he has distributed an estimation of $11 billion to the investors who suffered (Benner).

Ultimately, the Justice Department hopes to collect a grand total of $4 billion to give to victims, in addition to the funds that had previously been distributed by Picard. This will be possible by not only taking the assets of Bernie Madoff’s family, but also taking those belonging to the investors who gained massive sums of money from the fraudulent scandal. The Justice Department does not find it fair that some people profited greatly, while others lost everything. Interestingly enough, JP Morgan Chase, the bank responsible for allowing Madoff’s fraud to
escalate, is most likely getting about $2 million seized from it. The victims are, to this day, being fought hard for. As stated earlier, Madoff’s Ponzi Scheme destroyed numerous lives in the most abrupt way possible. According to Benner, “the firm’s collapse claimed thousands of victims including pension funds, foundations, a philanthropy established by the Holocaust survivor Elie Wiesel, and wealthy individuals like the actors Kevin Bacon and Kyra Sedgwick.”

To receive compensation, victims of the scandal were required to submit a petition. To date, a total of 39,000 petitions have been accepted and approved (Benner). Although this does not include all of the victims, it is definitely a start. It can be reasonable to believe that most affected investors accepted their losses and doubted they would ever receive portions of their money back. However, this scandal was too large to not take any actions and attempts to fix what had been done. This is the sole reason why the Madoff Victim Fund was created—to try to ease the suffering of those individuals, organizations, and companies that had invested various amounts in Bernard L. Madoff Investment Securities LLC. In sum, justice is still presently being served and efforts are still being made to provide victims with what they deserve, step by step.

In conclusion, fraud has been an issue in the accounting field for many years. To combat it, laws and protocols were developed, such as the Sarbanes-Oxley Act and the Public Company Accounting Standards Board. Auditors play a significant role in the detection and prevention of fraud by assessing financial statements that are presented to them. It is up to companies, especially the executives within them, to fairly present their financial information. If they neglect to do so, then they could be accused of accounting fraud, as seen in previous scandals. All professionals should be held to a high standard in the accounting profession, including auditors, senior accountants, management, and executives of an organization. Accounting fraud is never
something to take lightly and progress is constantly being made to close the gap between the instances of it that take place and its complete eradication.
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