Corporate Fraud

Case Studies in Detection and Prevention

JOHN D. O'GARA

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About the Author

John D. (Jack) O’Gara is retired Senior Director—Audit for a Fortune 250 multi-industrial company. O’Gara has managed internal audit departments for three Fortune 250 companies for “multiple decades.” Prior to that, he spent six years in Big Eight (at that time) public accounting, including consulting and two years’ international residency in Brussels, Belgium, and in Kuwait. He was president of the Central Ohio chapter of the Institute of Internal Auditors (IIA) in 1999–2000, and was the conference chairman for the IIA 2000 Central Regional Conference. He is currently on the IIA Central Ohio chapter board of governors.

O’Gara is currently developing an interactive online case-study-based version of the types of management fraud and corruption depicted in this book and has presented seminars on the topic of management fraud. He says that a fraud investigation while he was in public accounting sparked his interest in management fraud; it has been his avocation as well as his vocation ever since. As such, he has maintained continuing correspondence with major fraud practitioners for the last 20 years and has drawn from that correspondence in presenting certain cases herein.
About the Institute of Internal Auditors

The Institute of Internal Auditors (IIA) is the primary international professional association, organized on a worldwide basis, dedicated to the promotion and development of the practice of internal auditing. The IIA is the recognized authority, chief educator, and acknowledged leader in standards, education, certification, and research for the profession worldwide. The Institute provides professional and executive development training, educational products, research studies, and guidance to more than 80,000 members in more than 100 countries. For additional information, visit the Web site at www.theiia.org.
Preface

Approximately 80 percent of this book had been drafted prior to Enron exploding on the national consciousness. My initial emphasis was exclusively on major management fraud against the organization, which would exclude financial reporting. After Enron, I held up: I thought the interest in management non-financial-statement fraud would be diminished, if not eclipsed. Moreover, I felt that the developing Enron saga might render the collected case studies paltry in comparison.

As the Enron story unfolded, however, it became clear that nothing that I had written needed to change: the Enron case had all of the elements and dynamics discussed herein because it was first an overarching management fraud and only secondly a financial-reporting fraud. On February 11, 2002, the Business Roundtable commented that Enron “. . . appears at this point to derive fundamentally from a massive breach of trust” [emphasis ours]—which is what all management fraud ultimately entails.

I had originally intended to omit fraudulent financial reporting, not because it was insignificant, but because so much on the topic was already available in the professional literature. The day after I presented the dynamics of management non-financial-statement fraud to the IIA International Conference, however, the WorldCom “Accounting 101” fraud hit the news and brought home the interrelationship of all elements of management fraud. To consider one element of management fraud more important than any other is to miss the point: Major management fraud is all about leveraging positional power and is an interrelated top-down phenomenon—fraud for the organization leads to fraud against the organization, and vice versa.

Consequently, senior management financial-reporting fraud for and operating-management fraud and corruption against the organization are not independent. Moreover, the forensic auditor of the future will identify symptoms of both by way of continuous monitoring using information
technology to identify the footprints and early warnings available in the data of the organization. Although operating-management corruption typically occurs off the books, continuous monitoring symptoms will be recognizable in the data available within the organization's records once a market perspective is established.

Thus, I have broadened the focus to include corporate governance and top-level forensic issues, as well as other aspects of fraud for the organization. Although this is not about Enron or WorldCom, you will find much about the Enron and WorldCom dynamics reflected in the concepts illustrated by these case studies.

The primary fraud role of the internal audit function is recognition of the symptoms indicating that fraud may have occurred. Since major management fraud involves leveraging positional power more than it involves taking advantage of internal control weaknesses, effective recognition requires a management as well as an accounting perspective. Recognition of major management fraud is an art rather than a science, and it depends on a principle-based understanding of the dynamics.

In keeping with the principle-based aspect of recognition, I have started the sections devoted to the particular fraud classification with a discussion of the concept behind that type of fraud. Then, I present a brief discussion of the principles, followed by a list of specific symptoms and an illustrative case study (or studies).

The case studies are totally fictional. None of them happened as depicted herein, although all could have happened as so portrayed. The cases are designed to illustrate the principles and concepts of their respective sections, as well as to entertain. The characters, events, and incidents are drawn from the author's imagination and are not to be construed as real. Any resemblance to actual events or persons, living or dead, is entirely coincidental.
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