CASE STUDY - FINANCIAL MISSTATEMENT FRAUD

Fraud Deconstructed: Manipulating Expenses To Achieve Promised Profits

BACKGROUND

A global food company, faced SEC allegations of inflating profits through deceptive accounting practices. The SEC investigation revealed that the company manipulated expenses to meet publicly-announced cost-saving targets over three years.

DETAILS OF THE FRAUD

The company announced cost savings from its merger and tied procurement staff performance targets to these savings. To meet expectations, the company entered into arrangements for upfront cash payments and discounts tied to future commitments, recording these prematurely as cost savings contradicting general accounting practices. When the COO was informed of potential expense manipulation, he allegedly pushed staff to meet unrealistic targets. Several transactions were improperly recorded, understating costs of goods sold by a substantial amount over the three-year review period.

CLIENT IMPACT

Due to an SEC subpoena, the company initiated an internal investigation that identified a large amount of understatement of its costs of goods sold.

The company was fined by the SEC for violation of federal securities laws. Additionally, the COO received a fine, while former CPO received a fine along with a five-year prohibition from assuming officer or director roles within publicly traded companies.

AT A GLANCE

How was fraud committed?

- The procurement division entered various supplier contracts that required up front payments from suppliers including:
  - upfront discounts and credits from suppliers received in exchange for future purchasing commitments; and,
  - agreements to reduce current prices, to be offset by future price increases.
- The Procurement division claimed that these supplier payments related to savings earned in the current or prior years. The company obscured its obligations for future consideration given in exchange for current benefits and caused the finance team to account for these cost savings prematurely.
- As a result of understaffing, the legal department responsible for reviewing supplier contracts overlooked inconsistencies between contract documents and negotiated transactions.

How could have this been prevented?

- Foster a strong ‘tone at the top’
- Develop strong internal controls and review of key accounting practices.