Accountability: What's in Store

Impact on the Profession

The events of the last eight months have shown us the fragility of our economic structure, but they have also given us the opportunity to learn from past mistakes. With accounting and legal exposure rising to epidemic proportion, it is a professional obligation to both a client and oneself to comprehend all that will arise.

The current market is still reeling from corporate misdeeds and accounting malpractice. With investor confidence down and accounting liability on the rise, knowledge and integrity are going to play an integral role in survival. As knowledge is key, we can learn from the mistakes of others.

Adelphia Communications Corp.

The SEC is currently investigating the cable television provider's financial records. It was revealed in March that the Rigas family (owner, founder) engaged in off-the-books borrowing to use an estimated $3.1 billion in company assets to invest in personal items, including a golf course. John J. Rigas and his two sons have been arrested on a variety of charges, including the RICO act and could face 100 years each if found guilty.

Arthur Andersen LLP

The 89-year old accounting firm was found guilty in June 2002 on charges of obstruction of justice for destroying Enron documents. It was also the auditor involved in Worldcom, Qwest, and Global Crossing accounting scandals. Andersen's Boston office, which had more than 800 employees before the news of the scandals broke, now employs less than 100 and is expected to shut its doors within weeks.

Enron

Enron filed for Chapter 11 bankruptcy on December 2, 2001, due to overstated earnings from money transfers involving special purpose entities that were created to allow Enron to show artificially inflated net income. According to Mark Cheffers of Director Malpractice.com, "Taken together with other financial manipulations these SPEs created a circumstance where it is now questionable whether Enron had any real net income from 1997 and forward." Due to the accounting impropriety, thousands of investors and employees with 401(k) plans lost their life savings.

Global Crossing

The bankrupt telecommunications giant, which filed for bankruptcy in January of this year due to alleged accounting malpractice, currently face two federal probes into their finances. They allegedly exchanged network capacity with other firms to inflate revenue. It is scheduled to auction off certain assets on July 31, 2002.

Halliburton

The SEC is investigating the oil services company's accounting policies. Vice President Dick Cheney was the CEO from 1995 to 2000. It faces at least 10 securities fraud lawsuits.

ImClone Systems, Inc.

Sam Waksal (former CEO) was arrested June 12 on charges of insider trading and perjury. It is suspected that Waksal informed family and friends to sell due to an FDA

perjury. It is suspected that Waksal informed family and friends to sell due to an FDA refusal to consider its application for Erbitux, a new cancer drug. The SEC is expected to take civil action for alleged improper disclosure of information about Erbitux.

Martha Stewart Living Omnimedia

Martha Stewart is currently being investigated for alleged insider dealings by selling nearly 4,000 ImClone shares one day before the FDA announcement that it would not consider the application for Erbitux. CEO Sam Waksal was a close friend of Stewart and telephone records indicate that they had spoken to each other that same day. Waksal also attempt to unload his 72,000 shares after his daughter sold hers for $2.5 million.

Merck & Co., Inc.

Merck overstated its earnings by more than $12.4 billion due to the Medco pharmacy-benefits unit. The Medco unit manages pharmacy-benefit programs for employers and health insurers and included as part of its revenue the co-payments collected by pharmacies from patients, even though Medco does not receive those funds. These nonexistent co-payments represented nearly 10 percent of Merck's overall reported revenue during this period.

Rite Aid Corp.

Four top Rite Aid executives were indicted on charges of inflating earnings to boost stock price. Three of these executives also falsified contracts to give themselves millions in extra severance pay, and two are accused of perjury and witness tampering. The CEO, Martin L. Grass, allegedly moved $2.6 million in company funds to a real estate business that he owned.

Tyco International Ltd.

Dennis Kozlowski (former CEO) is currently under investigation for using corporate funds to buy personal items, including art and a house. He also allegedly had empty crates shipped to the corporate warehouse in New Hampshire in order to avoid paying $1 million in sales tax on $13.1 million in art that currently resides at his Manhattan apartment.

Qwest Communications Inc.

Qwest is being investigated in relation to network capacity swaps with companies such as Global Crossing. It has admitted to accounting improprieties and $1.16 billion in improper revenue, which it is currently restating. According to Dick Notebaert, chairman and CEO, "Accounting errors were made. They will be corrected."

Xerox

Xerox announced in June that it would restate up to $2 billion in revenues over a five-year period due to improper accounting. This is in response to pressure from the SEC, which said Xerox had inflated results and defrauded investors.

WorldCom Inc.

The telecommunications giant had overstated its earning by more than $3.8 billion in just five quarters — the largest case of accounting fraud ever.

just five quarters — the largest case of accounting fraud ever.

Civil charges have been filed by the SEC, and its co-founder and CEO Bernard J. Ebbers resigned with an investigation continuing on both his involvement in cooking the books and the $366 million in personal loans that he received from the company. WorldCom, which is the second largest long distance company, filed for Chapter 11 bankruptcy protection on July 22, 2002.

The result of these scandals remain to be played out in criminal trials, bankruptcy proceedings and civil law suits. Whatever the outcomes, Donovan Hatem LLP will continue to keep abreast of liability and risk management issues created by the sweeping industry changes.

00691872

©2002 Donovan Hatem LLP
Two Seaport Lane, Boston MA 02210
Telephone: 617-406-4500 • Facsimile: 617-406-4501