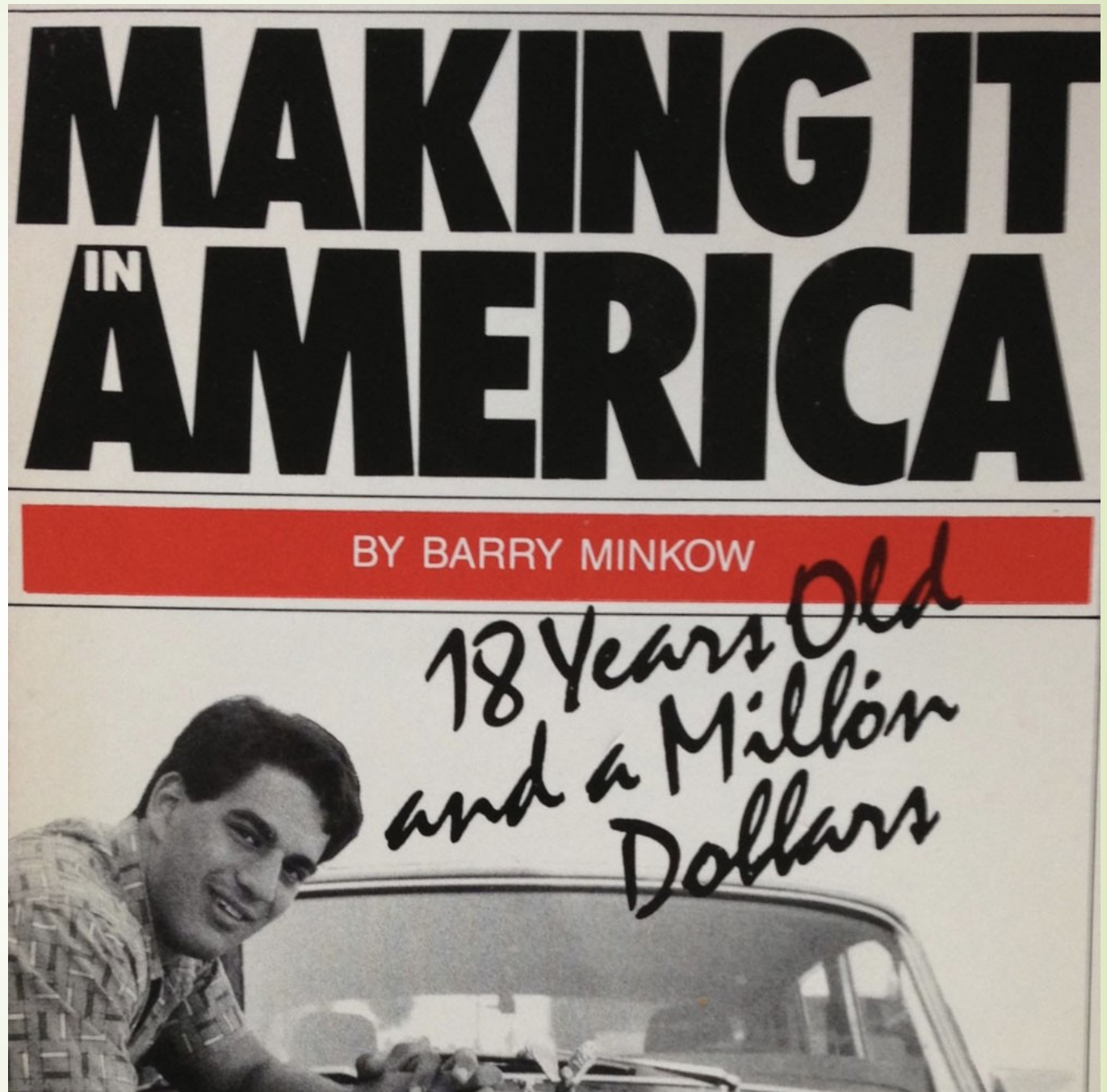
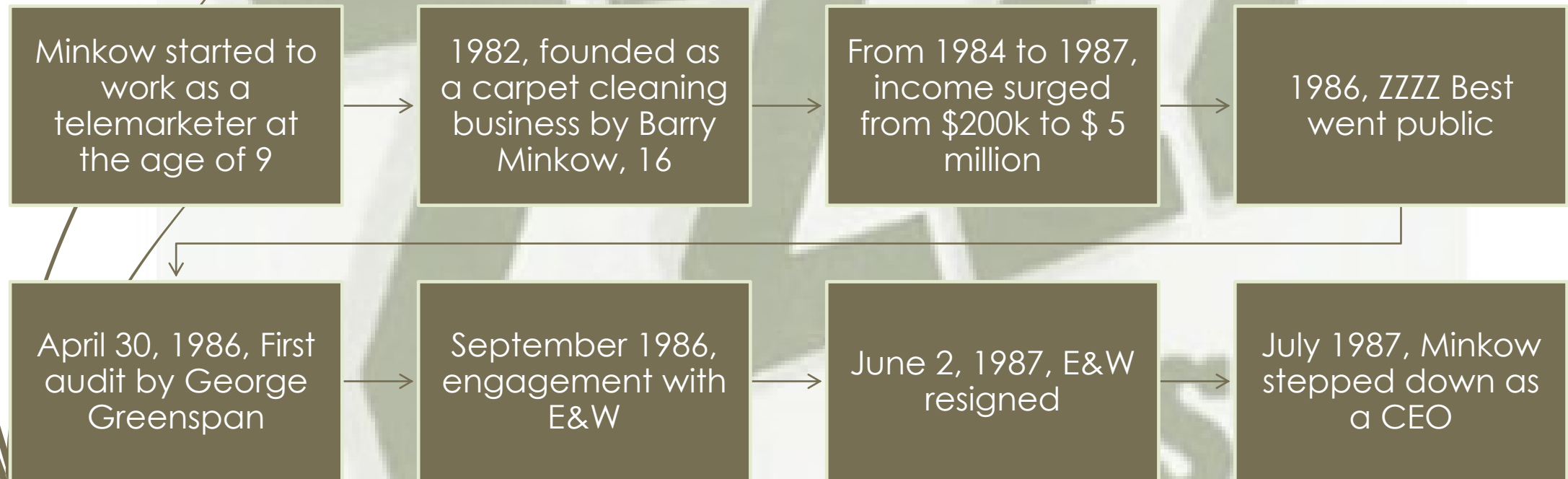


Barry Minkow: Anatomy of a Conman

By Alptekin Han Sofuoglu



History





Profit Generation

Carpet cleaning is a cutthroat business

Check kiting, credit card forgeries, staging theft for insurance

Tom Padgett, Insurance claim adjuster


Phony contracts to generate paper profits

Loans from the banks

No need for an actual business

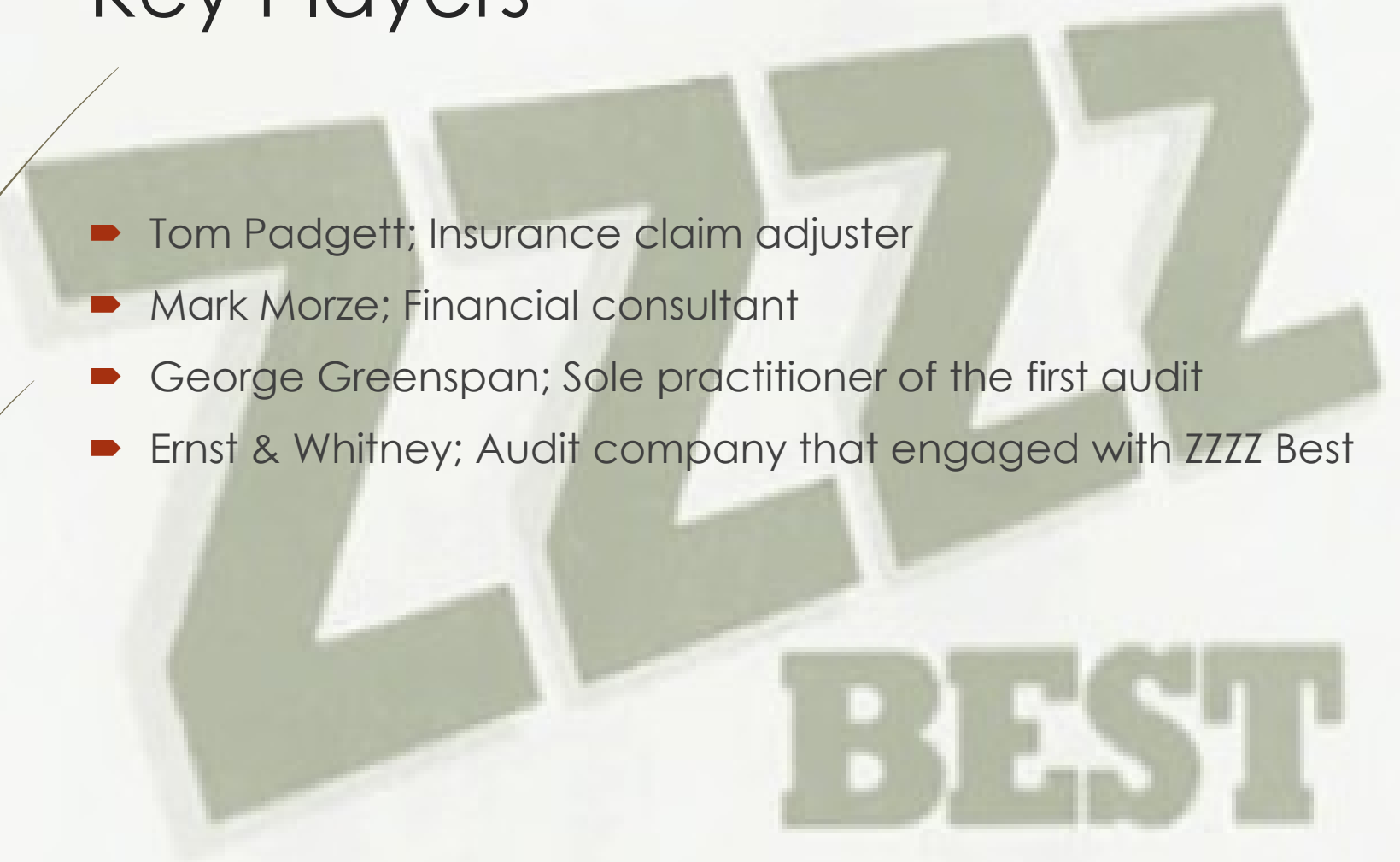


Going Public

- 
- ▶ Went public in 1986
 - ▶ No more control over firm's financial disclosures
 - ▶ Had to register with SEC
 - ▶ Requirement for auditors, investment bankers, and outside attorneys to examine the firm's financial statements



Key Players

- 
- ▶ Tom Padgett; Insurance claim adjuster
 - ▶ Mark Morze; Financial consultant
 - ▶ George Greenspan; Sole practitioner of the first audit
 - ▶ Ernst & Whitney; Audit company that engaged with ZZZZ Best




First Auditor: George Greenspan

- ▶ April 30, 1986, full scope audit by George Greenspan
 - ▶ He confirmed the firm's major restoration contracts by contacting Tom Padgett
 - ▶ Interstate Appraisal Services to generate fake insurance contracts
 - ▶ George testified that he performed analytical procedures to identify the unusual relationships in financial data
 - ▶ Reviewed all key documents but never inspected any restoration sites
- 



Second Auditor: Ernst & Whinney

- ▶ Hired to increase the company's credibility(Big 8 at the time)
- ▶ Miscommunication with the first auditor
- ▶ Engagement letter between E&W and Minkow
 1. A review of the company's financial statements for the 3-month period
 2. Assistance in the preparation of a registration statement to be filed with the SEC
 3. A comfort letter to be submitted to the company's underwriters
 4. A full scope of audit for the fiscal year



Second Auditor: Ernst & Whinney

- ▶ E&W reps said that they asked to see the large construction sites, but Minkow refused.
- ▶ Found two large restoration sites in Sacramento, rented it, put company signs on it, and paid to the security to greet the auditors as a ZZZZ Best employee
- ▶ Minkow signed a confidentiality agreement with E&W auditors
- ▶ No follow-up phone calls to any contractors, insurance companies, the building owner, or the individuals involved in the restoration contract
- ▶ Resigned due to questionable integrity of Minkow




Question 1: Review vs. Audit

Review


- ▶ It does not require a substantive test
- ▶ It can be on one financial statement
- ▶ It has moderate level of assurance
- ▶ It has negative assurance assertion

Audit

- ▶ It is a thorough examination of the books of accounts of an entity to check if they are true or not
- ▶ It includes an opinion on all of the client's financial statements
- ▶ It includes a risk assessment

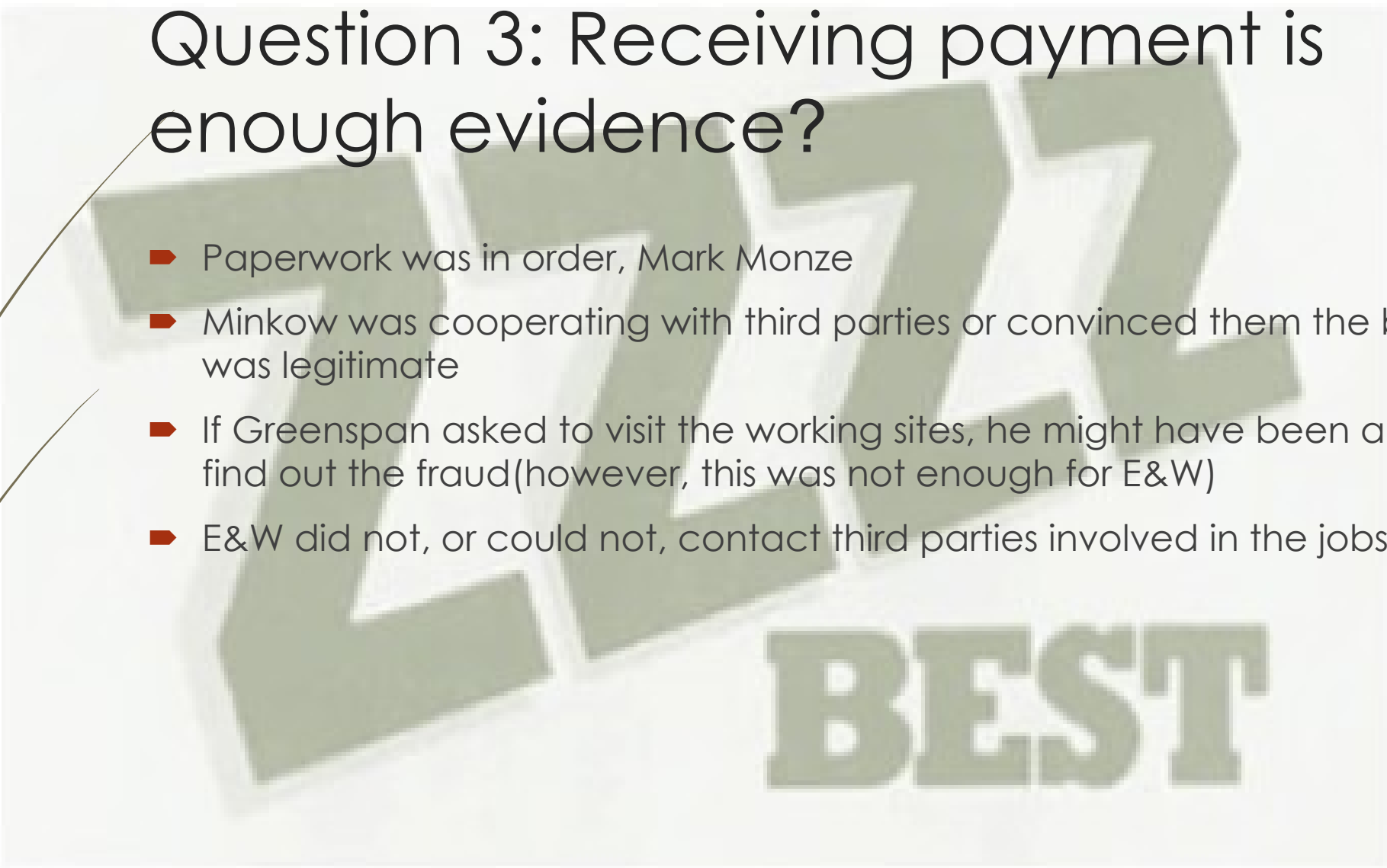


Question 2: Management Assertion of Occurrence

- ▶ *The transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity*
 - ▶ Documents were misleading
 - ▶ Requiring more restoration sites to visit
- 



Question 3: Receiving payment is enough evidence?

- ▶ Paperwork was in order, Mark Monze
 - ▶ Minkow was cooperating with third parties or convinced them the business was legitimate
 - ▶ If Greenspan asked to visit the working sites, he might have been able to find out the fraud (however, this was not enough for E&W)
 - ▶ E&W did not, or could not, contact third parties involved in the jobs
- 

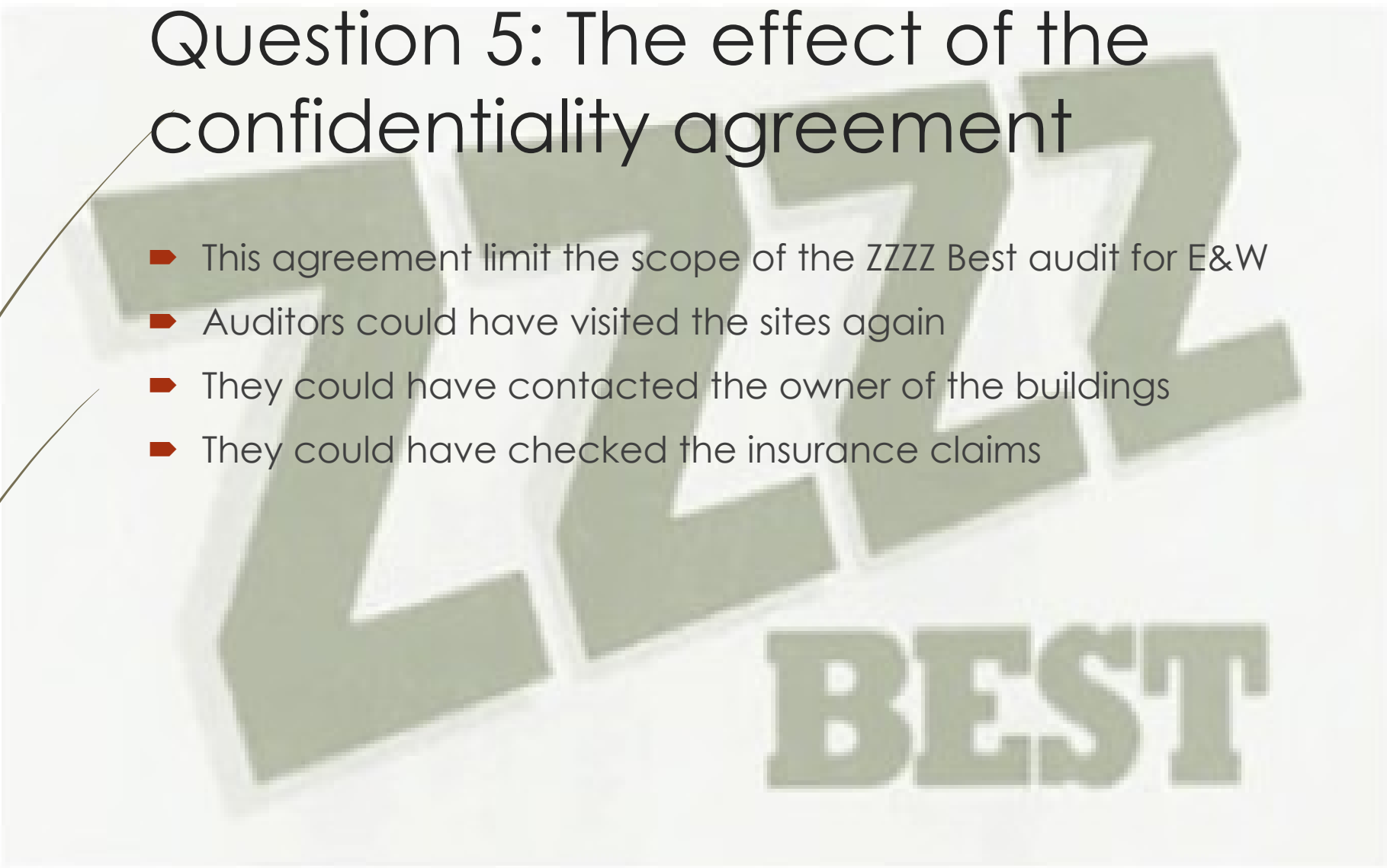


Question 4: Predecessor-successor auditor communication

- ▶ The purpose of the predecessor-successor auditor communications is to help an auditor determine if a firm should engage with a new client
- ▶ Successor must attempt to communicate with the predecessor
- ▶ Client must give permission
- ▶ Successor must ask for the reason for the change and the integrity of the management
- ▶ Access to the work paper up to the predecessor
- ▶ Predecessor should inform about integrity or frauds



Question 5: The effect of the confidentiality agreement

- ▶ This agreement limit the scope of the ZZZZ Best audit for E&W
 - ▶ Auditors could have visited the sites again
 - ▶ They could have contacted the owner of the buildings
 - ▶ They could have checked the insurance claims
- 



Question 6: Required professional standards to perform when reviewing a client's preaudit report

- ▶ There is no professional standards for reviewing a client's preaudit report
 - ▶ There is, however, post-year-end earnings press release
 - ▶ Auditor should review the post-year-end earnings release
 - ▶ Discussion whether this is good for investors or not, delayed information
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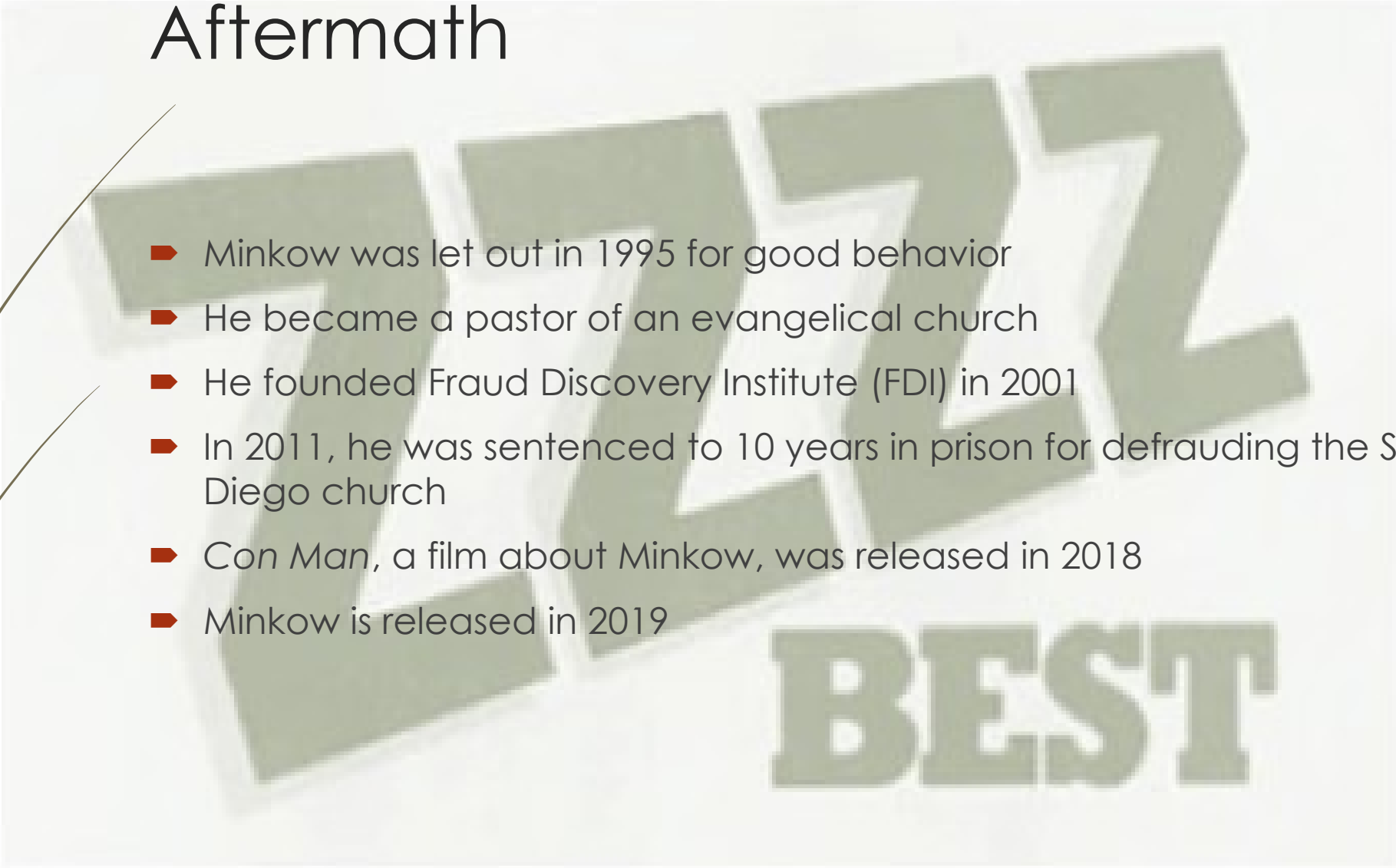


Unravelling the Fraud

- ▶ A woman complained she was overcharged contacted LA Times
- ▶ LA Times released an article about Minkow
- ▶ Minkow made a press release reporting record profit without E&W's knowledge
- ▶ Third party information about Minkow's fraudulent activities to E&W
- ▶ May 29, 1987, E&W discovered several cancelled checks to this informant
- ▶ June 2, 1987, E&W resigned
- ▶ July 1987, Minkow resigned
- ▶ 1988, Minkow sentenced 25 years in prison



Aftermath

- ▶ Minkow was let out in 1995 for good behavior
 - ▶ He became a pastor of an evangelical church
 - ▶ He founded Fraud Discovery Institute (FDI) in 2001
 - ▶ In 2011, he was sentenced to 10 years in prison for defrauding the San Diego church
 - ▶ *Con Man*, a film about Minkow, was released in 2018
 - ▶ Minkow is released in 2019
- 



THANK YOU!

BEST