

WAS THIS ACCOUNTING FRAUD HIDING IN PLAIN SIGHT?

Cynthia B. Lloyd, University of Houston Downtown

ABSTRACT

This case study describes a defalcation that most likely occurred due to mutual cross-business unfamiliarity among accountants. Rather than focusing on just accounting incompetence as the contributing factor in fraudulent activity, removing cross-industry silos is imperative in the current accounting profession. Hence, this case explores fraud through a multi-lensed approach that incorporates qualitative factors utilized in the forensic accounting profession for detecting financial offenses. Additionally, I look at potential weaknesses in regulatory oversight across a series of at least three groups of accountant and regulatory bodies. Accounting students are rarely offered a behind the scenes exposure to the role of forensic accountants in the bankruptcy context, hence this study gives students insights about high regard given to the profession of forensic accounting in the bankruptcy arena. This case, which was drawn from a series of facts published in the popular press, offers a proverbial workshop in the complexities surrounding accounting failure. In this presentation of the unforeseen progression long-term defalcation, readers are better prepared to utilize their research, communication, and critical thinking skills for addressing real issues they might encounter in the accounting profession after graduation.

Keywords: Accounting Fraud, Bankruptcy Trustee, Forensic Accountant, Participation Loans.

INTRODUCTION

Worley & Obetz was a Manheim, Pennsylvania based energy company with propane, home heating oil, natural gas, gasoline, diesel, and HVAC businesses. The company collapsed in May 2018 upon the revelation that CEO Jeffrey Lyons had directed a 15-year scheme to falsify \$2 billion of revenue on Worley & Obetz's books. Lyons was criminally convicted as the leader of financial statement defalcations in order to continue influencing its four bankers to loan a total of \$65 to \$74 million to the firm. Since Worley and Obetz was apparently quite influential in its small borough with a population of less than 4,900, at no time during the 15-year fraud scheme did bankers or other financial statement users question the veracity of the company's records¹.

Lyons began his fraudulent scheme shortly after he became Worley & Obetz's CEO in 1999. Lyons' mission was to make Worley & Obetz appear more profitable than it actually was. Additionally, Lyons' goal was to make himself appear successful as the firm's CEO. So, in furtherance of his goals, Lyons asked controller, Karen Connelly, to falsify the company's financial statements to make it appear to have the grossly inflated millions in revenue and accounts receivable than it actually had. Lyons and Connelly continued the fraud scheme from

¹ Ex-CEO of Worley & Obetz pleads guilty to fraud, to pay \$55 million restitution
https://lancasteronline.com/business/local_business/ex-ceo-of-worley-obetz-pleads-guilty-to-fraud-to-pay-55-million-restitution/article_72e290d2-f723-11e9-9521-4f5209373373.html

2003 until 2016, when Connelly retired. Then, Judith Avilez became the controller and joined the ongoing fraud in the same manner as Lyons and Connelly when Connelly retired. Just as her predecessor did, Avilez created false Worley & Obetz financial statements each month which Lyons presented to Fulton Bank to support of his requests for additional loans or extensions on existing lines of credit.

According to Worley and Obetz's vice chairman and co-owner Seth Obetz, while Worley and Obetz's CEO Jeffrey B. Lyons, and accomplices, controller Karen Connelly, and her successor controller, Judith Avilez perpetrated the frauds, at least one CPA firm Trout, Ebersole & Groff failed in its duties to discover the frauds².

Purportedly, three weeks after the failure of a plan to win the backing of Fulton to rescue the company, Worley & Obetz abruptly ceased operating and filed for Chapter 7 bankruptcy liquidation³.

None of the four banks, and none of the potentially six groups of accountants noticed the 15 years of defalcations surrounding Worley and Obetz's, a private energy supplier company's fraudulent overstatement of its assets. Not until Worley and Obetz ultimately declared insolvency through filing a voluntary Chapter 7 bankruptcy petition for liquidation on June 6, 2018, did a forensic accountant reveal the firm's fraudulent framework. Before its demise, Worley and Obetz, a privately owned energy company, operated more than five fueling stations in and around Lancaster County, Pennsylvania. Since the firm was not publicly traded, consumers and the business-to-business community had to rely upon the integrity of internal and external accountants, the auditing or review engagement competence of Worley and Obetz's CPA firms, the lending banks' reporting requirements, the indirect protections through SEC regulations, banking regulators, the internal revenue service and finally the forensic accounting skills utilized and the availability of criminal prosecution powers in the federal bankruptcy trustee system. The settlement between the accounting firms and the bankruptcy trustee indicates that the trustee accused the accounting firms of failing to discover that most of Worley & Obetz's revenues were deceptive.

Further, the trustee alleged that Worley and Obetz executives' pattern of incurring loans were intended to keep the company operating while maintaining the appearances of a profitable company. In separate proceedings from the accounting-firm investigations the Chapter 7 trustee alleged embezzlement of the illicit loans also occurred. Trustee Shubert indicated that Worley and Obetz's fraudulent scheme also provided extra cash to draw from, that assisted the firm's executives and their relatives in buying approximately 20 properties as personal investments. Even so, the trustee relented to Worley and Obetz's insiders who defended their real estate transactions as beneficial to Worley and Obetz and therefore appropriate in light of the company's operations. Hence, in settling the dispute between the insiders and the trustee, only six of the properties were sold to non-Worley and Obetz affiliated owners⁴.

² https://lancasteronline.com/business/local_business/worley-obetz-2-accounting-firms-settle-with-trustee-pay-425-000-deny-any-liability/article_2395334e-0a7d-11ec-b510-e3cd5d5dbbee.html

³ TIM MEKEEL, Staff Writer Jun 7, 2018, Worley & Obetz files for bankruptcy liquidation, cites up to \$100M in debts https://lancasteronline.com/business/local_business/worley-obetz-files-for-bankruptcy-liquidation-cites-up-to-100m/article_64d16f96-6a6a-11e8-882e-9ba24e996435.html

⁴ Worley & Obetz trustee seeks expert to check the timing, purpose of payments to 18 suppliers; TIM MEKEEL, Staff Writer Jul 3, 2019 https://lancasteronline.com/business/local_business/worley-obetz-trustee-seeks-expert-to-check-the-timing-purpose-of-payments-to-18-suppliers/article_5be9ac40-9cf5-11e9-ae8a-efd73f0d791a.html

The Chapter 7 Bankruptcy Trustee

While the bankruptcy trustee is not a government employee, the Chapter 7 trustee is the official representative of the bankruptcy estate. . In chapter 7, the trustee liquidates property of the estate and makes distributions to creditors. Moreover, through the statutory powers granted under the supervision of the United States Trustee or Bankruptcy Administrator, the trustee serves as the responsible party whose role is to review the debtor's filings, including the petition and schedules, and to recover property of the bankruptcy estate. The trustee is authorized to make such recovery by bringing such actions necessary against creditors or the debtor to facilitate such asset recovery⁵.

The court-appointed trustee Christine Shubert, in supervising Worley & Obetz's bankruptcy liquidation, activated the recoupment of as much money as possible on behalf of Worley & Obetz's creditors. Hence, the trustee employed a forensic accountant who asserted that, but for Trout CPA and H2R CPA's irresponsible conduct or incompetence, Worley & Obetz's fraud could not have occurred and continued. As such approval is required by US bankruptcy law, the CPA firms' settlements were officially acknowledged and accepted by Chief US Bankruptcy Court Judge Magdeline Coleman.

The Negligent or Complicit CPA Firms

According to a statement by Seth Obetz, vice chairman and a co-owner of Worley & Obetz who was not implicated in the defalcation, "*accounting work*" for Worley & Obetz was performed for many years by Trout CPA, formerly Trout, Ebersole & Groff. And, another accounting firm, H2RCPA, the former Horovitz, Rudoy & Roteman, was retained by Worley & Obetz to review Trout's work⁶.

As a strategy used in settling with the trustee, the accounting firms "*asserted various defenses,*" such as they were not hired to perform audits procedures to verify Worley & Obetz's financial claims. Rather, the firms indicated that they "*were only retained to conduct a more limited review of those records.*" In making these assertions, the CPA firms' insolence created "*a substantial controversy*" between the CPA's and the Chapter 7 trustee. The settlement agreement reported that such contentious and fractured negotiations prompted the "*desire [of both sides] to resolve [the accounting negligence issues] without the need to resort to costly judicial proceedings.*"

In comparison to an audit engagement, a review engagement is considered weaker than an audit engagement. In an audit engagement, the auditor is required to perform more rigorous procedures before issuing a statement of positive assurance. Hence, in an audit engagement, the auditor is required to demonstrate that they understand the company's internal control systems. To that end, the auditor must perform a full range of verification, substantiation, inquiries, and analytical procedures. As compared to an audit, since there is less effort involved, a review engagement requires less time than an audit engagement.

⁵ Fraudulent Activity In A Bankruptcy Case Whom Do I Notify If There Is Possible Fraud?

<https://www.cacb.uscourts.gov/faq/fraudulent-activity-bankruptcy-case-whom-do-i-notify-if-there-possible-fraud>

⁶ Worley & Obetz abrupt closure Monday 'horrible beyond belief,' owner says: with earlier layoffs, about 250 out of work, HEATHER STAUFFER, Staff Writer Jun 4, 2018 Updated Jun 4, 2018,

https://lancasteronline.com/news/local/worley-obetz-abrupt-closure-monday-horrible-beyond-belief-owner-says/article_8d37d12a-6829-11e8-b72d-dbd6819e06e2.html

On the other hand, a review engagement provides only a limited level of assurance that a company's financial statements comply with the applicable financial reporting framework. Since review engagements give users such limited assurance on the accuracy or correctness of financial statements, it is quite surprising that bankers who lend millions of dollars would allow such a low level of assurance as that provided by a review engagement⁷.

A settlement with the CPA's was reported by the trustee only as to the total amount paid by the CPA firms, and not in terms of a detailed breakdown of the amounts paid by each CPA firm. The bankruptcy trustee publicly referred to the settlement only in terms of the "*alleged damages sustained by Worley & Obetz as a result of the accounting and review services that the Accounting Firms provided.*"

Although Worley & Obetz's two accounting firms, Trout and H2R denied the allegations as to any liability, and as to any negligence or any misconduct, the two accounting firms paid a combined \$425,000 to settle all claims by the Chapter 7 bankruptcy trustee that their accounting work caused unspecified harm to Worley & Obetz or its stakeholders.

The Bankruptcy Trustee's Forensic Accountants' Audit of Worley & Obetz

Out of concern for an audit failure, in January 2019, retroactive to December 2018, the bankruptcy trustee, on behalf of the Worley & Obetz bankruptcy estate, requested the bankruptcy court's approval to hire Friedman LLP, an expert in detecting accounting malpractice. The trustee stated that Friedman's mission is to investigate Trout CPA's work on Worley & Obetz's books and to "*reach conclusions regarding their conformity with professional standards.*"

The Worley & Obetz bankruptcy estate reportedly spent \$48,000, performing 110.5 hours of work to investigate the Trout and H2R accounting firms' work. Therefore, this shows that since the negotiated settlement amount was nine times more than the costs of the forensic accounting malpractice expert work performed by Friedman LLP, including partner who billed the most per hour - as high as \$695 an hour, employing a forensic accountant was well worth the costs incurred.

In submitting its bill for services to the trustee, Friedman reported that it "*provided expert forensic, accounting, auditing and litigation support services, which included review of work papers and work product of Worley & Obetz's accountants in connection with the [trustee's] preparation of a malpractice complaint.*" While the complaint was never made public, negotiations between the CPA and the trustee proceeded.

Bankruptcy experts are aware that it's not unusual for bankruptcy trustees to send a letter to a CPA firm privately demanding reimbursement to compensate the bankruptcy estate for financial damages allegedly caused by a CPA firm. The CPA firm is incentivized in that by settling and avoiding a public trial, the firm avoids having the allegations becoming public.

The Victimized Banks

In ascending order, from smallest to largest losses, the four victimized banks are –

⁷ Review Engagement vs Audit Engagement, Corporate Finance Institute, <https://corporatefinanceinstitute.com/resources/knowledge/finance/review-engagement/>

(1) Franklin Financial of Pennsylvania's subsidiary bank, Farmers and Merchants Trust Co., which operates as F&M Trust, estimates that its net income for the second quarter of 2018 will be reduced by between \$7.9 million and \$9.1 million due to the fraud scheme.

(2) S&T Bancorp, Inc. and Subsidiaries Provision for Loan Losses show an increased \$4.4 million and \$1.7 million to \$9.3 million and \$11.8 million for the three and six months ended June 30, 2018 compared to \$4.9 million and \$10.1 million for the same periods in 2017. S&T further reports that the increases in the provision for loan losses were mainly due to higher net charge-offs in 2018 which were significantly impacted by a \$5.2 million loan charge-off for a commercial customer, Worley & Obetz, arising from a participation loan agreement with a lead bank (putatively Fulton), in both periods⁸. For the three and six months ended June 30, 2018, S&T had net charges-offs of \$7.9 million and \$7.7 million compared to net charges-offs of \$5.3 million and \$7.5 million for the same periods in 2017. In an apparent "*all in a day's work*" style, S&T indicates that the provision for loan losses is the amount to be added to the allowance for loan losses, or ALLL, after considering loan charge-offs and recoveries to bring the ALLL to a level determined to be appropriate in management's judgment to absorb probable losses inherent in the loan portfolio. In implicating the involvement of other participating banks, S&T reports to the SEC that the loss resulted from fraudulent activities believed to be perpetrated by one or more executives employed by the borrower and its related entities. Annualized net loan charge-offs to average loans were 0.55 and 0.27 percent for the three and six months ended June 30, 2018 compared to 0.37 and 0.26 percent for the same periods in 2017. The higher provision for loan losses was also due to an increase in substandard commercial loans. Substandard commercial loans increased \$75.0 million from \$89.7 million at June 30, 2017 to \$165 million at June 30, 2018⁹.

(3) Uninvest Corp. of Pennsylvania took a \$12.7 million charge-off in connection with its commercial loan loss due to Worley & Obetz officer's fraudulent activity. Uninvest Corp., the parent corporation, reports an expected reduction in its second quarter 2018 net income in its SEC filing. Furthermore, the parent corporation reports that it expects to incur a total loss in loan and leases losses through its subsidiary bank, Uninvest Bank and Trust Co.'s ownership of a participating interest of \$13 million in the Worley & Obetz "*commercial lending relationship*"¹⁰.

(4) The lead lender in the loan participation group is Fulton Financial which reports the largest loss. In Fulton's SEC filing¹², it reports "*working with the borrower and its owners to preserve and recover assets for the benefit of the corporation and the other participating lenders; however, at this time the corporation is not able to quantify the amount of any additional recoveries that may be realized in excess of what is reflected in the current loss estimate.*" Further, reportedly in its filing, Fulton is taking an even bigger hit in the estimated second quarter 2018 net income reduction of up to \$32 million. And, "*as of May 30, 2018, the*

⁸ <https://blog.swbc.com/lenderhub/the-6-benefits-of-using-participation-loans>.

⁹ ST Bancorp 10Q 2018630, 10-Q 1 stba-201863010q.htm 10-Q

<https://www.sec.gov/Archives/edgar/data/0000719220/000071922018000066/stba-201863010q.htm>

¹⁰ Bank Notes Uninvest takes 12.7M charge for alleged Worley Obetz loan fraud,

<https://www.bizjournals.com/philadelphia/news/2018/07/30/uninvest-worley-obetz-loan-fraud.html>

¹¹ Alleged fraud at Worley & Obetz's appears to snag 4th bank in PA; total bank loss rises to nearly \$62M, TIM MEKEEL, Staff Writer Jun 4, 2018, https://lancasteronline.com/news/local/alleged-fraud-at-worley-obetz-s-appears-to-snap-th/article_8d92895e-680a-11e8-813a-4751d045fc14.html

¹² 10Q Fulton Financial Bank 6302018

<https://www.sec.gov/Archives/edgar/data/0000700564/000070056418000035/fult630201810q.htm>

Corporation's outstanding credit exposure to the borrower and its related entities was approximately \$48 million, which is net of approximately \$32 million of participation interests held by other financial institutions¹³."

Loan participations and loan syndications are terms often interchanged to describe a lending arrangement involving more than one lender; however, for accounting and reporting purposes, these are two different types of transactions with unique considerations and issues.

Over the years, around 2009, loan participation programs have increasingly gained popularity among larger banks. The benefits touted in the banking industry for loan participation include (1) the capacity for the lead bank to originate larger loans within its own legal lending limits and still obtain sufficient cash for funding the loans; (2) sharing the profits of the lead bank for banks not doing much business on its own—or is in a slow lending market—generates more lending income, (3) the bank's credit risk is reduced and allows for diversification of the bank's assets, for investing in a variety of loan types while reducing exposure to losses such during severe economic downturns or natural disasters, (4) enhances customer relationships since the lead bank can keep control of the relationship with an important customer rather than share such customer rapport with competing banks, (5) banks can potentially share the loan servicing responsibilities on behalf of all of the participants. In summary, loan participation provides the "mechanism to manage regulatory limits, interest rate, liquidity, credit and geographic concentration risks, as well as an enhanced ability to serve customers. Financial institutions buying loan participations may benefit from diversifying their balance sheet, using excess liquidity, and increasing revenue." On the other hand, these multiple benefits are met with multiple regulatory compliance and due diligence requirements.

Loan syndication

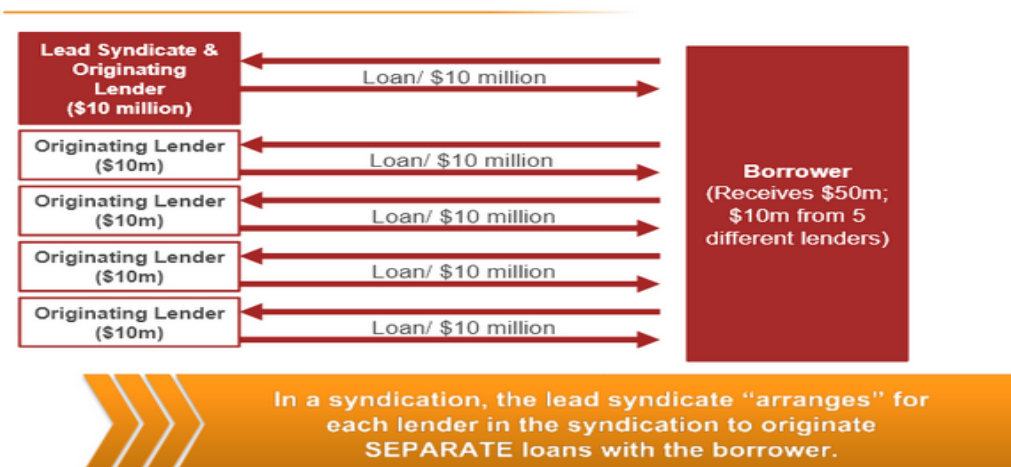


Figure 1
LOAN PARTICIPATION MAP

¹³ Signs point to Worley & Obetz as cause of \$32M loss for Fulton Financial TIM MEKEEL, Staff Writer Jun 1, 2018 Updated Jun 1, 2018 https://lancasteronline.com/business/local_business/signs-point-to-worley-obetz-as-cause-of-m-loss/article_364c7e2e-6595-11e8-ad44-17f0df3e81f3.html

Source: <https://www.gaapdynamics.com/insights/blog/2021/06/29/loan-participations-vs-syndications-whats-the-deal/>, LOAN PARTICIPATIONS VS. SYNDICATIONS: WHAT'S THE DEAL? Posted on Jun 29, 2021 by Bob Laffler, CPA

Criminal Charges, Guilty Plea and Court Convictions of Worley & Obetz's Executives

(1) Fraud perpetrator Jeffrey B. Lyons – The fraud was uncovered in May 2018 when the new controller, Judith Avilez told one of the co-owners, Obetz about the long-running fraud. After learning that the fraud was uncovered, Lyons skipped town rather than attend a meeting with another Worley & Obetz executive and a representative of Giant. Lyons purportedly knew that the meeting would uncover his fraud scheme. In any event, Lyons was fired that same day. After disappearing for a period of time around the time the scam was revealed, and having been found 1,100 miles away in Minnesota at one point and later in North Dakota where he was found by police, the 58-year-old Worley & Obetz former CEO returned home. Ultimately, Jeffrey B. Lyons pleaded guilty to one count of bank fraud and one count of tax evasion before a Pennsylvania U.S. District Judge. The former CEO was also accused of using \$1 million of credit card debt. In furtherance of his fraud, to substantiate the deceptive financial statements, Lyons also presented a falsified version of Worley & Obetz's contract with its biggest customer, Giant Food Stores, to Fulton bank. Lyons went so far as continuing to present the fraudulent financial statements after 2011, when Giant stopped buying fuel from Worley & Obetz. Fulton Bank "*relied upon*" falsified financial documents and the bogus contract in its decisions to loan more and more money to Worley & Obetz. Lyons was also allegedly used Worley & Obetz funds to build his personal real-estate portfolio of six investment and vacation properties.

During his plea hearing in federal court on Oct. 25, 2019, Lyons admitted that he orchestrated and championed the 15-year fraud while heading Worley & Obetz. The fraud Lyons perpetrated ultimately wiped out the firm, costing all of its 270 employees their jobs. Lyons' plea deal requires the payment of \$55.4 million in restitution to Fulton Bank, the lead bank victim of the fraud.

(2) Karen Connelly who was 65 years old at the time the fraud's discovery, was the initial accountant who was instrumental in facilitating the Worley & Obetz fraud – As Worley & Obetz's corporate controller, Connelly used her accounting skills to perpetrate the fraudulent misconduct that was advocated by Lyons. On a Tuesday, on November 5th, 2019 in a Pennsylvania federal court, Connelly, the former controller admitted her guilt. Connelly admittedly produced reams of inflated financial statements to deceive Worley & Obetz's lending banks. Connelly, a local resident, pleaded guilty to one count of bank fraud for her role in the fraud scheme that misled Fulton Bank, the lead bank, along with its three other participating bank group members into lending Worley & Obetz \$74 million over a 15-year period. Connelly was sentenced in federal court to four years in prison for her role in the company's bank fraud, despite blaming the bullying and reassurance of CEO who orchestrated, for her participation during the first 13 years of the fraud. In 2020, Connelly, then 66 years of age, was ordered to pay restitution to the main victim of the fraud, Fulton Bank, in the amount of \$25.4 million. Moreover, although the advisory federal sentencing guidelines recommend an eight to 10 year prison sentence and a fine of up to \$1 million, Connelly was convicted to only 4 years in prison scheduled to start serving on November 13, 2020, and she was not fined¹⁴.

¹⁴ Worley & Obetz exec gets 4 years in jail for role in \$67M fraud, says CEO bullied her into it, TIM MEKEEL, Staff Writer Sep 24, 2020, https://lancasteronline.com/business/local_business/worley-obetz-exec-gets-4-years-in-jail-for-role-in-67m-fraud-says-ceo/article_9a4a7acc-fe48-11ea-9bfd-e7458ca50806.html

The federal prosecutor, asked for the more lenient sentence of four to five years in prison, mentioning Connelly's cooperation with investigators and her willingness to testify against Avila, had she taken her case to trial¹⁵.

On the other hand, Connelly's attorney, requested a sentence of home confinement citing Connelly's age, nonviolent offense, diabetic medical problems and lack of prior offenses met the federal criteria for using home confinement to lessen prison populations in light of widespread COVID-19 outbreaks during time served behind bars.

In her apology to the victims of her crime, Connelly stated that "*My mistake was following the directives of Jeff. He was very convincing,*" said Connelly, saying Lyons regularly pledged he would "*make it right*" through acquisitions or new ventures that would yield so much profit he could make the real finances catch up with the phony figures. Connelly also asserted that the CEO "*intimidated*" her with his bursts of temper. Connelly stated that even though she retired, Lyons made her take a company computer home so she could keep supplying him with fraudulent documents until July 2016 when she finally said she was done implementing the ruse. Even with her retirement, Lyons ordered Connelly to have her successor, Judith Avilez take over the task, with Lyons taking Avilez to Connelly's home in order to have Connelly train Avila in the techniques used for the fraudulent scheme.

Connelly's attorney maintained that, unlike Lyons, Connelly reaped no financial reward from her participation in the fraud scheme. And, that Connelly, whose annual salary was \$130,000, only got anxiety and depression from the stress brought on by the fraud. The federal judge, however, decided that a prison sentence was warranted due to the duration of Connelly's central role in the fraud and due to the devastation the fraud inflicted on employees, owners and lenders of Worley & Obetz. The judge reminded Connelly that she "*knows right from wrong*" and that stating she was just following orders is never a defense.

(3) On October 17, 2018 Worley & Obetz's bankruptcy trustee alleged that Judith Avilez, the successor controller to Connelly, participated in the conspiracy with Lyons and Connelly to put \$2 billion in fake business revenue and assets on Worley & Obetz's books, so the firm could borrow more money, which Lyons appropriated to buy real estate. In September 2020, Avilez, pleaded guilty to her role in the fraud scheme. Then, on February 4, 2021, more than two years after the original allegations, 60-year-old Avilez was sentenced to three years in prison, five years of supervised release, and was ordered by the judge to pay \$15 million in restitution for participating in the \$65 million bank fraud scheme. In her plea bargain, Avilez admitted that she helped Worley & Obetz's CEO, Jeffrey Lyons defraud Fulton Bank by creating fraudulent financial statements from 2016 through May 2018 and by grossly inflating accounts receivable for Giant Food, Worley & Obetz's largest customer¹⁶.

In addition to the foregoing, Worley & Obetz's former CEO and controller were also charged with scamming the company by paying \$1 million of the CEO's personal credit debt.

¹⁵ Id.

¹⁶ Judith Avilez Sentenced for Participating in \$65M Bank Fraud, February 4, 2021 Waqar Nawaz, <https://www.stl.news/judith-avilez-sentenced-for-participating-in-65m-bank-fraud/434911/>

CONCLUSION

The Chapter 7 bankruptcy trustee's allegations of fraud, along with criminal charges, the federal court's meting out of three criminal prison sentences along with restitution requirements illustrate an actual case of fraudulent financial reporting and embezzlement. Notably, this case reinforces the implausibility of an accounting firm providing only a review engagement rather than an audit engagement to avoid tactical defalcations when millions of dollars are at stake. Questions are provided in the next section of this case study. Suggested solutions are provided in a separate document which can be obtained from the author.

Questions

1. Omnibus Statement of Standards on Accounting and Review Services – 20xx: Fraud guidance is provided under SSARS No. 12 such that not only are accountants not required to assess the risk of fraud, accountants need not report illegal acts that are clearly nonconsequential. In that Worley & Obetz's accountants were only engaged to review the company's financial records during the 15 years of accounting fraud, what actions should Trout CPA and H2R CPA have taken in this regard? Is the guidance under SSARS No. 12 adequate under the circumstances? If not, what is the source of guidance that should have been followed under the circumstances?
2. Valuation of Worley & Obetz's Assets: Since Worley & Obetz's financial statements must have clearly overstated the company's assets, what should the bankers and regulators have done with regard to potentially detectable discrepancies in fair value measurements and disclosures required under GAAP, FASB ASC 820? What qualitative factors (for example, an individual's versus entity's conflicting goals) may have prevented the bankers, accountants and financial statement users' yearly failure to detect Worley & Obetz's overstated asset valuations and other financial statement discrepancies¹⁷?
3. Audit Risk Assessment: both Trout CPA and H2R CPA apparently determined that Worley & Obetz was a low risk client. What factors should the CPA firms have considered prior to accepting this client as a review engagement? State your answer by identify and explaining which factors may have altered the CPA firms' assessment of Worley & Obetz from low risk to high risk.
4. Weak indirect accounting oversight by regulatory bodies including the SEC: In light of Worley & Obetz's private firm status, explain how the duties of at least two regulators of private firms could aid in avoiding harmful fraud schemes that effect stakeholders.
5. Participation Loans: Explain the benefits of participation loans for all stakeholders, not just the lending institutions. Explain why membership in participation loans could hinder the appropriate assessment of risk by bank auditors. Explain why membership in participation loans could misdirect regulators from problematic lending.
6. FDIC Risk Management Examination Policies: Refer to the FDIC DSC Risk Management Manual of Examination Policies. How did Worley & Obetz's lending banks depart from FDIC's guidance under several problematic categories. Explore the relevant categories for the analysis of "Potential Problems, Warning Signs, and Suggested Actions." What accounting issues should the lead participation bank have considered when renewing Worley & Obetz's loans throughout the 15 years of renewing its loans? What accounting issues should the other participating banks have considered with regard to Worley & Obetz's loan history over its 15 year series of loans?¹⁸
7. Bankruptcy Trustees: Identify the responsibilities or regulatory duties of bankruptcy trustees to generally protect stakeholders of a bankruptcy estate, especially investors, creditors and employees in detail. Cite at least one federal statute (or code section) that authorizes bankruptcy trustee to take such protective measures¹⁹.
8. Use of Forensic Accounting Experts in Court: What professional standards are relied upon by judges each of the parties in a court of law for accepting the opinion of an expert? Explain how these standards apply

¹⁷ (<https://www.gaapdynamics.com/insights/blog/2021/06/29/loan-participations-vs-syndications-whats-the-deal/>)

¹⁸ FDIC Manual, Section 9.1, Insider Abuse, <https://www.fdic.gov/regulations/safety/manual/section9-1.pdf>

¹⁹ Handbook of Chapter 7 Trustees, 2012, <https://www.justice.gov/ust/page/file/762521/download>

differently in a bankruptcy case, if at all. Research the Daubert standard for allowing expert testimony to determine when it is applicable. Explain the appropriate use of the Daubert standard²⁰.

9. Criminal Fraud Sentencing and Civil Fraud Penalties: Identify differences between criminal and civil fraud. Identify the distinction between the possible range of penalties under each category of fraud.
10. Judicial Discretion: Give at least five examples of the use of judicial discretion to deviate from sentencing guidelines. Mention specific examples of the circumstances under which a judge may be more prone to use judicial discretion.

Case Learning Objectives and Implementation Guidance

For countless of reasons upper management in numerous privately held firms have been involved in such frauds as that championed by the CEO in this case. The rationalization for such fraud ranges from the need to give investors, bankers and other stakeholders a positive view of the company, to earn more revenue or simply convert the funds of the company to the individual's personal use.

Accounting transactions are recorded representations of a business' financial health, and are thus reported in accordance with Generally Accepted Accounting Principles (GAAP) in the United States. While it is the auditor's duty to ensure that financial transactions are reported in a fair manner so that the firm does not mislead its stakeholders, accountants who are only engaged to review the company's records should not escape their duty to stakeholders by simply declaring that their engagement is limited to a review engagement, and not an audit engagement. In this actual case of a carefully planned accounting fraud, the perpetrators of the accounting fraud used accounting gimmicks in plain sight to present financial statements that were completely misleading. Undoubtedly, even after the passage of Sarbanes Oxley, this scheme escaped scrutiny since the company was privately held and not subject to public scrutiny.

As Worley & Obetz's accounting fraud was conducted in such a cavalier manner, and conducted at such a high level, it ruined the lives of many stakeholders of this company. For instance, at least one banker must have suffered personally in the face of failing to detect Worley & Obetz CEO's defalcation although he was highly praised by his colleagues upon his retirement from S&T Bancorp. Although the fraud at the hands of Jeffrey Lyons was so effectively laid out that even the bankers and the auditors may have failed to detect it, this case draws to question whether even the reviewing accountants who did not recommend actually engaging auditors over the 15-years of defalcation should have been deemed guilty, or willing participants in Lyons' ploy. This case invites discussions regarding accountants' negligence in discharging their duties. Obviously, with Worley & Obetz employees losing their jobs and the firm's co-owners losing their hard-earned money, this case presents an opportunity to exam whether accountants, bankers, investors and regulators should lead the charge in mandating the heightening of private company oversight.

Advanced accounting, auditing, accounting research, accounting ethics, business ethics, forensic accounting and business law courses are designed to inspire student's academic inquiry, increase students' appropriate discernment in multiple contexts, and enhance their research competencies.

Since his case is designed to be used in countless undergraduate and graduate courses, it can be tailored for use in finance, banking courses and human resources courses as well. This fraud case offers the opportunity to teach and learn a wide range of lessons in business.

²⁰ Id., Debtor Audits, Page 4-42; 9) REFERRAL OF POTENTIAL BANKRUPTCY CRIMES, a. DETECTING CRIMINAL ACTIVITY, Page 4-43

Learning Objectives

At the conclusion of this case, students should be able to:

1. Explain and apply the Omnibus Statement of Standards on Accounting and Review Services – 20xx: Fraud guidance under SSARS No. 12 (Question 1)
2. Explain and apply the pertinence of valuation fair value measurements and disclosures under GAAP, FASB ASC 820 (Question 2)
3. Explain the importance to nonaccountants of financial reporting risk assessment by identifying and explaining which factors aid in determining the differences between low risk to high risk (Question 3)
4. Use research skills to identify, explain and apply the regulatory differences between public and private companies (Question 4)
5. Use research skills to explore the indicators of weak accounting oversight by regulatory bodies (Question 4)
6. Explain and apply the accounting engagement standards related private companies.
7. Explain how multimillion dollar participation loans may provide too much “comfort” to all stakeholders involved (Question 5)
8. Use research to locate and explain bank reporting to the SEC and appropriate standards in banking to determine best practices when evaluating the appropriate accounting and auditing standards by debtors (Question 6)
9. Explain in detail, the roles of bankruptcy trustees in association with a firm's liquidation resulting from a fraud scheme (Question 7)
10. Explain the need for a forensic accountant as an expert witness in court cases and identify how to scrutinize the proficiency of such expert by using the traditional Daubert standard (Question 8)
11. Use research skills to determine the differences between punishment for criminal fraud by imprisonment and civil fraud by paying financial penalties (Question 9)
12. Explain the meaning of judicial discretion and how it might be used (Question 10)
13. Identify risks associated with the failure to scrutinize internal and external loyalties to top management (Questions 8, 9 and 10)
14. Use research skills to identify bullying models used by top management that exert power to create a workplace culture in which employees feel vulnerable, anxious and uncertain (Questions 8, 9 and 10)

Core competencies addressed in this case include critical thinking, research, decision making, ethics, collaborative problem solving/teamwork and communication skills.

Implementation Guidance

The instructor has flexibility in determining the level of difficulty and whether to use this case in undergraduate or graduate advanced accounting, auditing, accounting research, accounting ethics, business ethics, forensic accounting or business law courses.

Timing, Format, and Comprehensiveness of the Assigned Case. Although this case is newly designed, I anticipate assigning this case to students in a graduate accounting course that teaches numerous topics related to professionalism for accountants. When assigning the 10 case questions, I expect to assign this case as a mid-term group project which will require working in teams outside of class so that teams can meet virtually. Since the context of this case is fairly broad, depending upon the course objectives, and the timing needed for addressing other course objectives, some questions can be eliminated. Since this case is based on actual events, in such cases like this, students typically report that they are encouraged to continuously do research to follow the individuals, the company and its successor, the accountants, and its banks well into the future after this assignment is complete and submitted for a grade. Moreover, students have offered feedback in the past that when cases are based on actual events, they tailor the case for

utilization in other course in which they are currently, or will be enrolled. I also find that when requiring student to present their results from research the questions in this type of case, a sense of competition develops among the groups such that each student will deploy a heightened level of critical thinking and communications skills. As I have done in other case-based assignments in the recent past, due to restrictions imposed by COVID-19, I will have individual students prepare a video for presenting their individual viewpoints and analysis of the case to fellow students. However, since students are quite adept at holding virtual meetings if this case is assigned as a group assignment, utilizing this case for group assignments will allow for greater coverage of the range of topics presented in this case. This case is sure to inspire enlightening class discussions among class members.

Degree of Research: Since this case study utilizes the range of research from auditing standards, review engagement standards, bankruptcy requirements, and even to human resources decisions, the research requirements are consistent with the forthcoming 2024 CPA Evolution and the research skills utilized by accounting professional. Hence, instructors can tailor the order of complexity to address (1) require that the students begin researching the specific standards assigned in the questions, (2) assist the students in locating the standards, (3) pinpoint specific online financial reporting cites such as the SEC's EDGAR and AAER databases (www.sec.gov), IRS' criminal investigations division's (<https://www.irs.gov/compliance/criminal-investigation>) regulatory reports and the local US Bankruptcy Court's and US Trustee System's websites. Additionally, the instructor can tailor the case by eliminating parts of the case that are not consistent with the course learning objectives.

Critical Thinking: This case provides enough flexibility that the instructor can eliminate any parts that do not enhance the requirement for students to use their critical thinking skills.

Assessment: The questions used in this case are suitable for use in either in-class, or take-home exams. The questions provided in this case will assist the instructor in gathering student feedback either upon the submission of the case assignment or upon completion of this course.

Received: 20-Sep-2022, Manuscript No. AAFSJ-22-12585; **Editor assigned:** 21-Sep -2022, PreQC No. AAFSJ-22-12585(PQ); **Reviewed:** 05-Oct-2022, QC No. AAFSJ-22-12585; **Revised:** 10-Oct-2022, Manuscript No. AAFSJ-22-12585(R); **Published:** 17-Oct-2022