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FBI takes up heavy load of corporate fraud probes

By Andrew Caffrey, Globe Staff, 5/6/2003

The FBI is opening three to five investigations a month of suspected fraud of $100 million or more by executives at publicly traded companies, a pace that indicates the scandals that have rocked corporate America for the past 18 months show no signs of abating.

"I don't know that we're through the worst of it," said Keith Slotter, chief of the FBI's financial crimes section. "We thought we would have peaked by now and I don't believe we have, unfortunately."

The FBI is actively involved in about 100 cases of suspected fraud at companies, about 10 times the caseload before the alleged fraud at Enron Corp. erupted into public view in late 2001. "This is way beyond what we've ever experienced," Slotter said.

Including the FBI cases, the US Department of Justice said it is conducting about 200 ongoing investigations under the aegis of its Corporate Fraud Task Force, up from 130 a few months ago. The task force was created in July 2002 by President Bush, two weeks after WorldCom Inc. disclosed nearly $4 billion in improper accounting to boost profits, in one of the largest frauds in corporate history.

"Enron was certainly a wake-up call and the department made among its top goals to prosecute these cases, with the hope of restoring confidence in the marketplace," said Justice Department spokesman Bryan Sierra.

The number of new cases being pursued by investigators and regulators dashes the hopes of officials and ordinary investors that Wall Street's recent spate of scandals would fade into memory. In October, then-US Treasury Secretary Paul H. O'Neill declared in a speech, "I am confident that the worst of corporate scandals is behind us."

But companies continue to issue major restatements of financial results. In recent weeks, Tyco International Ltd., Charter Communications Inc., Gateway Inc, Bristol-Myers Squibb Co., and Royal Ahold NV, all of which have been under investigation by federal authorities, have disclosed that they had inflated revenue or revealed other fresh accounting problems.

Indeed, the pace of the disclosures has some worried that the relentless bad news will continue to undermine investors' faith in financial markets, depress stock prices, and rob legitimate companies of the capital they need to grow as the economy recovers.

"The cloud isn't off the market at all," said D. Quinn Mills, a professor at Harvard Business School and author of the new book "Wheel, Deal, and Steal: Deceptive Accounting, Deceitful CEOs, and Ineffective Reforms."

"People are only beginning to realize just how fraudulently Wall Street operates," he said.

The FBI's Slotter said investors were hoping the Enron case was an anomaly, "But now it's turning out not to be such an anomaly." "We're learning this is more commonplace than the average person thought."

The suspected fraud under investigation typically involves either false reporting of financial results, self-dealing or personal enrichment by executives, insider trading, and obstruction of justice.

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The government probes have snared some of the biggest names in corporate America, including AOL Time Warner Inc., Kmart Corp., and Martha Stewart, and have led to sweeping changes to prevent new abuses, including the passage last year of the Sarbanes-Oxley Act, which imposes tougher corporate governance standards and reporting requirements on publicly traded companies, their accountants, and their lawyers.

Two former Kmart executives have been accused of fraud, but Martha Stewart has not been charged with any wrongdoing involving her sale of stock in ImClone Systems Inc. No charges have been filed in the AOL Time Warner case, but the company disclosed in March that the federal investigation has turned up even more instances of questionable accounting than the $190 million restatement the company took last fall.

Slotter said one explanation for the explosion in new cases has been employees "gaining an understanding of what constitutes fraud" since details of cases like Enron and WorldCom were disclosed. A new FBI hot line, 888-622-0117, he added, has been "very beneficial."

Yesterday, in the most notorious case to come along this year, a former chief financial officer of HealthSouth Corp. pleaded guilty to bank fraud as part of what investigators said was a $2.5 billion scheme to inflate profits at the company, which is based in Birmingham, Ala.

The HealthSouth case in particular has unfolded with lightning speed since US prosecutors and securities regulators brought charges in March. So far, 11 former executives have pleaded guilty to various charges. Former chief executive Richard Scrushy has been accused by the Securities and Exchange Commission of accounting fraud for overstating earnings to meet Wall Street profit expectations, and yesterday in a Birmingham courtroom, the former chief financial officer, Aaron Beam, implicated Scrushy.

Sierra, the Justice Department spokesman, said the task force has brought charges against more than 200 individuals and secured convictions or guilty pleas from about 75. He said more precise numbers were not available.

Last week, 10 of Wall Street's largest securities firms agreed to a landmark $1.4 billion settlement after federal and state regulators accused them of misleading investors with compromised stock-analyst research that was produced in order to win investment banking business from corporate clients.

While it had long been suspected that securities analysts issued overly bullish outlooks about their firm's investment banking clients, the settlement included a bombshell about the sordid ways of Wall Street: that several securities firms were paying other research shops to write favorable reports on companies they were bringing public.

Investigators are also trying to determine if illicit activities at one company reflect a common practice in the industry involved. In February, for example, Royal Ahold, the owner of Stop & Shop Supermarkets, disclosed it had overstated $500 million in revenue related to promotional rebates by its U.S. Foodservice unit. Food distributors Fleming Cos. and Nash Finch Co. have also disclosed the SEC is investigating their businesses, including pricing practices and other accounting issues. Fleming has also said it would restate results by up to $85 million.

While precise numbers on accounting restatements this year aren't yet available, "What we're observing now is a continued increase in the rate of filings of restated financial statements during the first quarter of 2003," said Joseph Floyd, who leads the investigations practice and runs the Boston office for Huron Consulting Group, which performs financial and accounting investigations and other business services.

A Huron study released in January said there were a record 330 restatements in 2002, or 22 percent more than in the previous year. Floyd, however, pointed out that not all restatements involve wrongdoing. Some could arise from mistakes over applying accounting standards or confusion over changing rules.

The ongoing cases could again weigh on stock markets that are just now clawing back from a three-year bear market brought on by the economic recession and corporate scandals. Some analysts said markets will rally as companies report stronger profits. Others, such as Paul Lapides, director of the Corporate Governance Center at Kennesaw State University in Kennesaw, Ga., predicted stocks will have limited gains "because investors' confidence isn't going to be restored until they feel confident in their own companies." That may take a while. Slotter predicts the FBI won't conclude its investigations by the end of 2004. "We're looking at this as a multiyear tasking," he said. "How many years? I don't know, but it's certainly going to be with us for quite some time."

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