

ETHICAL TRANSGRESSIONS 2024

TALES OF CORRUPTION

FRAUD ALERT
ACCESS

INSIDER TRADING

DATA BREACH

BACKUP
CRYPTO SCHEME
PROTECTION

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Tales of Corruption: Ethical Transgressions

INTRODUCTION

In season two of Tales of Corruption, we investigate five actual scenarios where fraud was committed along with corresponding ethical decision-making models. From cryptocurrency investment schemes to insider trading and extensive timekeeping and startup frauds, you'll learn how these extreme transgressions could have been avoided. Examine the building blocks of a strong ethical culture to ensure you're equipped to identify problems and determine the best course of action.

Ethical decision-making models generally fall into two categories: step-by-step models and lens models. Step-by-step models generally give you steps to work through that will help lead you to an ethical decision. For example, the AICPA Conceptual Framework and the PLUS model are both a step-by-step approach. Lens models attempt to give you a big picture view of how ethical decisions are made. Learning more about how one can view an ethical decision through a lens model allows you to evaluate the situation from a high-level perspective in order to make the best decision possible.

The key to utilizing an ethical decision-making model is appreciating how they each may be useful depending on the circumstances. By better realizing what is needed in a given situation, you can do a better job of choosing the right decision-making model to address necessary issues.

At the end of this course, participants will be able to:

- Categorize the elements of pressure, opportunity, and rationalization in relation to fraud.
- Recognize the building blocks of a strong ethical culture.
- Define an ethical problem, identify and evaluate solutions, and determine the best course of action.
- Evaluate the filters of policies, legal, universal, and self in relation to fraud.
- Recall the AICPA Code of Professional Conduct when faced with ethical dilemmas.

MEET THE COURSE AUTHOR & GUEST EXPERTS

COURSE AUTHOR AND HOST

Clare Levison, CPA, CGMA
Owner, Inspired Responsibility

Clare Levison is the owner of Inspired Responsibility, a consulting company dedicated to delivering continuing education via positive messages and meaningful content that inspires change. She strives to help organizations bridge gaps in their current learning with inspiring programs and meaningful agendas that deliver the message, as well as the WHY behind the message, to propel employees from good to best.

Prior to starting Inspired Responsibility, Levison spent more than twenty years in the aerospace and defense industry involved in all aspects of management, project, and financial accounting, as well as government compliance. Levison also authored competitive proposal volumes, with a focus on creating compelling, compliant content and providing cost trend analysis and risk mitigation.

GUEST EXPERTS

Neena Shukla, CPA, CFE, CGMA, FCPA, CTP
Partner, PBMAres, Government Contracting Team Leader

Neena Shukla has extensive experience leading and managing assurance and consulting engagements, with a deep background advising on SEC compliance, mergers and acquisitions due diligence, revenue recognition, stock compensation, employee benefit plan audits, cybersecurity, fraud and forensic accounting. Her background includes working with varied types of businesses with a focus on government contractors, including those in the technology industry. In addition, she has clients in construction, real estate, not-for-profit, healthcare and manufacturing sectors.

Several special certifications add to Neena's knowledge and allow her to provide clients with deep insight to help them perform at their peak. She has earned the Government Contract Accounting Certificate demonstrating her understanding of the unique accounting-related rules, problems, practices and demands of government contractors. In addition to her CPA license, she holds credentials as a Certified Fraud Examiner (CFE), Chartered Global Management Accountant (CGMA) and Forensic Certified Public Accountant (FCPA). In addition, she is a peer reviewer of employee benefit plan engagements for the AICPA's Peer Review Program. Evidence of her commitment to the industry has been noticed by her colleagues as she has been named a Super CPA by *Virginia Business* magazine for her work in the Assurance category.

Neena embraces new technology and is a committed volunteer in the community with various organizations focused on empowering young individuals to pursue careers in STEAM, science, technology, engineering, art and math fields. In addition, she chairs annual and quarterly nonprofit events for a local cultural organization and volunteers with a food pantry in Loudoun County.

John Reynolds
Director of Finance, NFT42

John Reynolds is the Director of Finance for NFT42 and related entities who provide developer tools to safely and effectively test code related to NFTs and smart contracts. He previously served as Manager and US Lead FP&A Analyst for Block.one, a Leading Blockchain Software Developer and originator of the EOSIO protocol. He was a 2019 recipient of the Top 5 Under 35 award, and currently serves as Vice Chair on the Board of the VSCPA. John lives in Tampa, Florida with his wife Rebecca and three kids Evelyn, John, and Joel.

Asif Charania, CPA
Practice Leader, Keiter

Asif H. Charania is the Practice Leader of Keiter's Valuation and Forensic Services Practice. He has over 13 years of experience in financial consulting services. He specializes in valuation and forensic accounting, including financial investigations and litigation consulting services.

His valuation experience includes buy/sell agreements; ESOPs; fairness opinions; financial statement reporting (purchase price allocation and goodwill impairment); mergers and acquisitions; purchase/sale of a security; stock-based compensation; taxation (estate, gift and income tax); stockholder disputes; divorce; and complex securities (e.g., preferred stock, convertible preferred stock, options, warrants, and stock appreciation rights).

His litigation consulting experience includes assisting clients with development of strategy; analyzing industries and markets; evaluating liability issues; assisting with discovery; developing alternative theories of damages; quantifying economic damages (e.g., lost profits, unjust enrichment, reasonable royalty, diminution of value); preparing demonstrative exhibits for trial; preparing expert reports; and analyzing opposing experts' damage models. Types of litigations in which he has served as a consultant include breach of contract, business interruption, fraud, intellectual property infringement (trade secrets, patents, copyrights, and trademarks), marital dissolution, post-acquisition disputes, professional malpractice, shareholder disputes, tortious interference, and wrongful termination.

His financial investigation experience includes assisting with planning the investigation; assisting with discovery and obtaining evidence (analysis of documents and searching of public records); performing computer forensic analysis to identify questionable transactions and to recover documents; quantifying damages; preparing demonstrative exhibits for trial; and preparing expert reports. Types of matters include employee embezzlement, management fraud, and investment scams.

He has served clients in a variety of industries including technology, financial, construction, healthcare, retail trade, manufacturing, distribution, wholesale, government contracting, and professional services.

Kelly Pope, CPA
Associate Professor, DePaul University
Founder, Helios Digital Learning, Inc.

Kelly Richmond Pope is an Associate Professor in the School of Accountancy and MIS at DePaul University in Chicago, IL and founder of Helios Digital Learning, Inc. She received her doctorate in accounting from Virginia Tech and she is a licensed certified public accountant. She worked in the forensic practice at KPMG, LLP on anti-money laundering engagements, insurance fraud investigations, and fraud risk management projects. Kelly is a recognized expert in the forensic accounting field and has conducted forensic accounting seminars around the world for universities, corporations, and governmental entities.

Her research has been published in the Behavioral Research in Accounting, Auditing: A Journal of Theory & Practice, Journal of Business Ethics, CPA Journal and WebCPA. She co-authored *A.B.C.'s of Behavioral Forensics: Using Psychology to Prevent, Detect and Deter Fraud* published by John Wiley & Sons. Additionally, she writes for [Forbes.com](https://www.forbes.com) and has published articles in The Daily Beast, The Washington Post and PBS Need To Know.

Kelly is the creator and executive producer of the award winning educational white-collar crime documentary *Crossing the Line: Ordinary People Committing Extraordinary Crime*. Her current documentary, *All the Queen's Horses* which chronicles the largest municipal fraud in U.S. history, was released August 2017. She was selected by the TED Ed team to develop a teaching lesson on "*How People Rationalize Fraud*" which can be found on the TED Ed website. Her TEDx talk "*Why We Hate Whistle-blowers*" discusses the whistle-blower dilemma and the need for whistle-blowers in fraud discovery.

Kelly is a past board member of the Illinois CPA Society, a member of the Economic Club of Chicago, a mentor-editor for The OpEd Project, serves of the Board of Directors for Mercy Hospital and is faculty advisor to DePaul National Association of Black Accountants (NABA) student chapter.

CASE STUDY 1:

Paycheck Protection Program Fraud Scheme

Press Release from the Department of Justice, U.S. Attorney's Office

Tuesday, March 29, 2022

Man Convicted for \$27 Million PPP Fraud Scheme

A federal jury convicted a California man yesterday for submitting fraudulent applications seeking money from the Paycheck Protection Program (PPP), submitting false statements to a financial institution, and money laundering.

According to court documents and evidence presented at trial, Robert Benlevi, 53, of Encino, submitted 27 PPP loan applications to four banks between April and June 2020 on behalf of eight companies solely owned by Benlevi. In the applications, Benlevi sought a total of \$27 million in forgivable PPP loans guaranteed by the Small Business Administration (SBA) under the Coronavirus Aid, Relief, and Economic Security (CARES) Act. In his fraudulent applications, Benlevi represented that each of his companies had 100 employees and average monthly payroll of \$400,000, even though he knew that the companies did not have any employees or payroll expenses. The evidence further showed that Benlevi also submitted fabricated IRS documents falsely stating that each of the companies had an annual payroll of \$4.8 million.

Based on Benlevi's fraudulent loan applications, three of Benlevi's companies — 1Stellar Health LLC, Bestways2 Health LLC, and Joyous-Health4U LLC — obtained \$3 million in PPP funds. Although Benlevi falsely represented that the funds sought through the PPP loan applications would be used to pay payroll and certain other business expenses, the evidence showed that he instead used them for personal expenses, including cash withdrawals, payments on his personal credit cards, transfers to other personal and business accounts he controlled, and renting an oceanfront apartment in Santa Monica. In a single day, Benlevi withdrew from the Bestways2 Health account \$248,000 of PPP funds in cashier's checks, which were deposited into other accounts that Benlevi controlled.

Benlevi was convicted of bank fraud, false statements to a financial institution, and money laundering. He is scheduled to be sentenced on June 27 and faces up to 30 years in prison for each of the bank fraud and false statement charges, and up to 10 years in prison for each count of money laundering. A federal district court judge will determine any sentence after considering the U.S. Sentencing Guidelines and other statutory factors.

CASE UPDATE

On July 19, 2022, Benlevi was sentenced to 11 years and three months in prison for submitting fraudulent applications seeking money from the Paycheck Protection Program (PPP), submitting false statements to a financial institution, and money laundering.

The Fraud Triangle

A tool you can use when exercising decision-making is the fraud triangle. Fraud experts generally agree that three elements need to coalesce for fraud to occur:

1. **Pressure** – The motivation behind the fraud, such as personal debt or a person's feeling that their job might be in jeopardy.
2. **Opportunity** – The situation that allows the fraud to occur, like weak internal controls or inadequate accounting policies.
3. **Rationalization** – The justification that allows the person committing the fraud to see it as an acceptable act. For example, "I need to take care of my family," or "They treated me wrong."

In relation to the case study, look for the elements of pressure, opportunity, and rationalization and the potential for them to coalesce.



CASE STUDY 2:

An Extensive Timekeeping Fraud

Press release from the Department of Justice, U.S. Attorney's Office, Eastern District of Virginia

Wednesday, March 13, 2019

Former DoD Employee Sentenced to Prison for \$1.4 Million Fraud Scheme

NEWPORT NEWS, Va. – A Matthews woman was sentenced today to four years in prison for computer fraud and theft of government property in connection with an extensive timekeeping fraud that resulted in losses of over \$1.4 million, which she was ordered to pay in restitution.

According to court documents, Michelle M. Holt, 52, was previously employed as a federal employee for the Department of Defense. Holt worked as a secretary for U.S. Air Force, Air Combat Command, Communication Support Squadron, at Joint Base Langley-Eustis. Holt was a salaried employee on the General Schedule (GS) grade for the federal civilian workforce. As such, she was entitled to overtime pay if authorized by her employer, was also entitled to other forms of holiday and annual leave, and premium pay for any federal holidays worked.

A law enforcement investigation determined that from December 2001 to July 2018, Holt falsely claimed over 42,000 hours in unauthorized overtime for hours she did not work, as well as other amounts of unauthorized holiday leave, sick leave and annual leave, all amounting to losses to the United States of more than \$1.4 million. In recent years, Holt's overtime pay was over double that of her regular salary. Holt accomplished the fraud by making manual retroactive adjustments to protected computer time and attendance systems to add overtime, reverse leave taken and reverse holiday leave. In doing so, Holt used another employee's log-in information without that employee's knowledge or authorization.

A copy of this press release is located on the website of the [U.S. Attorney's Office](#) for the Eastern District of Virginia. Related court documents and information is located on the website of the [District Court](#) for the Eastern District of Virginia or on [PACER](#) by searching for Case No. 4:18-cr-93.

CASE UPDATE

According to the [Federal Bureau of Prisons inmate locator](#), Michelle M. Holt was released from prison on January 13, 2022.

Society of Human Resources Ethical Culture Model

The SHRM model asserts that an ethical culture rests upon four building blocks:

1. Compliance

Compliance with rules and laws is the baseline, or minimum bar, in an ethical environment. You must have a solid foundation of compliance upon which to build the rest of your workplace.

2. Fairness

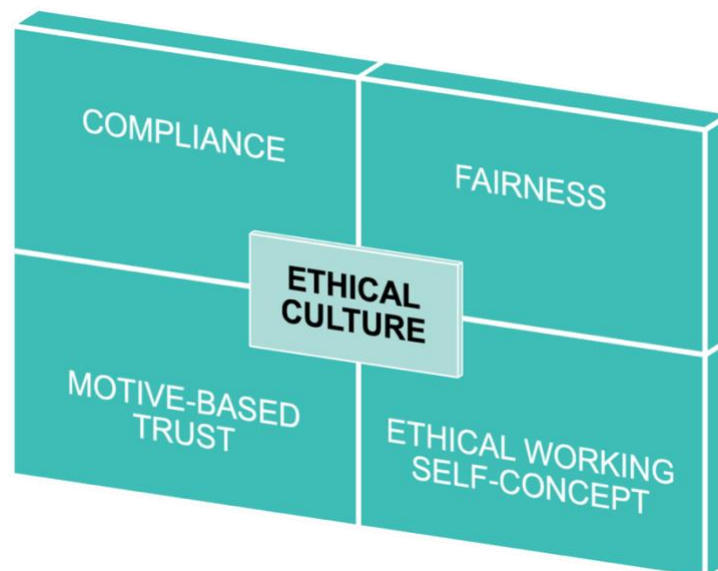
The Merriam-Webster Dictionary defines fairness as, "Lack of favoritism toward one side or another." Honesty, compassion and respect for rules and laws are a few of the values embraced in an ethical environment. Duplicity, self-interest and disregard for rules and laws are a few of the hallmarks of an unethical environment.

3. Motive-based trust

Motive-based trust is the level of trust that employees have in their co-workers and managers based on their observations of the ethical behavior of those co-workers and managers. Employees build motive-based trust by listening, admitting mistakes, and taking corrective actions.

4. Ethical working self-concept

Ethical working self-concept is the level to which employees internalize the ethical values of the organization. When the work environment promotes a high level of ethical working self-concept, employees will act in accordance with the organization's ethical values. Keep in mind that this building block cannot be established without the support of the other three blocks.



CASE STUDY 3:

Cryptocurrency Investment Scheme

Press release from the Internal Revenue Service

September 1, 2021

Director and promoter of BitConnect pleads guilty in global \$2 billion cryptocurrency scheme

SAN DIEGO — Glenn Arcaro of Los Angeles pleaded guilty today in federal court for his participation in a massive conspiracy involving BitConnect, a cryptocurrency investment scheme, which defrauded investors from the United States and abroad of over \$2 billion. The BitConnect scheme is believed to be the largest cryptocurrency fraud ever charged criminally.

As admitted in documents entered today before U.S. Magistrate Judge Mitchell D. Dembin, Arcaro conspired with others to exploit investor interest in cryptocurrency by fraudulently marketing BitConnect's proprietary coin offering and digital currency exchange as a lucrative investment.

Arcaro further admitted that he and others conspired to mislead investors about BitConnect's purported proprietary technology, known as the "BitConnect Trading Bot" and "Volatility Software," as being able to generate substantial profits and guaranteed returns by using investors' money to trade on the volatility of cryptocurrency exchange markets. In truth, BitConnect operated a textbook Ponzi scheme by paying earlier BitConnect investors with money from later investors.

"Arcaro and his confidantes preyed on investor interest in cryptocurrency. As a result, a staggering number of individuals lost an enormous amount of money," said Acting U.S. Attorney Randy S. Grossman of the Southern District of California. "The Department of Justice will continue to protect the investing public and scrutinize the burgeoning cryptocurrency industry. To those who would be the next in line to defraud the investing public, let this action by the Department of Justice stand as a stark cautionary tale. To the investing public, let this also serve as a cautionary tale to safeguard your money and invest it wisely."

It was through the use of social media, Arcaro acknowledged in his plea agreement, that he and others made materially false and misleading statements, while concealing material facts, all to persuade investors that BitConnect was a lucrative investment. During the scheme, Arcaro posted videos that mocked those who questioned whether BitConnect had a Trading Bot and Volatility Software, doubted the true identity of BitConnect's owner, and complained about losing their money in BitConnect.

According to the documents filed today, Arcaro sat atop a large network of promoters in North America, forming a pyramid scheme known as the BitConnect Referral Program. Arcaro earned as much as 15 percent of every investment into another part of the scheme—the BitConnect "Lending Program"—either from investors he recruited directly or those recruited by others beneath Arcaro in the pyramid. Arcaro further received portions of all investments from a concealed "slush" fund.

"Arcaro capitalized on the emergence of cryptocurrency markets, enticing innocent investors worldwide to get in early by promising them guaranteed returns, and exploiting the internet and social media to reach a larger pool of victims with greater ease and speed," said Special Agent in Charge Ryan L. Korner of the IRS Criminal Investigation's (IRS-CI) Los Angeles Field Office. "To conceal and further their scheme, Arcaro and his accomplices circumvented reporting regulations by the SEC and FinCEN, U.S. agencies that were created to protect investors and safeguard our financial systems. IRS-CI will pursue and root out these scams to protect investors and bring these financial fraudsters to justice."

"Arcaro has accepted responsibility for his actions of defrauding thousands of individuals worldwide to invest in BitConnect," said Special Agent in Charge Eric Smith of the FBI's Cleveland Field Office. "He lined his pockets with millions of dollars, money from victims that believed their funds were being invested into a new cryptocurrency with a high rate of return. Those choosing to engage in financial criminal deception should know the FBI will not stop until all fraudsters are identified and held accountable."

Arcaro admitted that he earned no less than \$24 million from the BitConnect fraud conspiracy, all of which, according to court documents, he must repay to investors.

Acting U.S. Attorney Randy S. Grossman thanked the FBI's Cleveland Field Office, IRS Criminal Investigation and law enforcement partners in India, Slovenia, and around the world for their efforts now and in the future, who assisted, and continue assist on this investigation. Grossman also thanked Assistant U.S. Attorneys Daniel C. Silva, Mark W. Pletcher, Lisa Sanniti, and Carl Brooker and Trial Attorney Kevin Lowell of the Criminal Division's Fraud Section who are handling this investigation. The Criminal Division's Office of International Affairs provided significant assistance in this matter.

In a parallel action, the U.S. Securities and Exchange Commission today announced civil charges against Arcaro and 3 others in connection with the same conduct.

CASE UPDATE

Arcaro was sentenced in September of 2022 to 38 months in prison.

On January 12, 2023, a federal district court in San Diego ordered that over \$17 million in restitution be distributed to approximately 800 victims from over 40 different countries due to their investment losses in BitConnect, a massive cryptocurrency investment scheme, which defrauded thousands of investors worldwide.

Santa Clara University Framework for Ethical Decision Making

This framework for thinking ethically is the product of dialogue and debate at the Markkula Center for Applied Ethics at Santa Clara University. Primary contributors include Manuel Velasquez, Dennis Moberg, Michael J. Meyer, Thomas Shanks, Margaret R. McLean, David DeCosse, Claire André, Kirk O. Hanson, Irina Raicu, and Jonathan Kwan. It was last revised on November 5, 2021.

Identify the Ethical Issues

- Could this decision or situation be damaging to someone or to some group, or unevenly beneficial to people? Does this decision involve a choice between a good and bad alternative, or perhaps between two “goods” or between two “bads”?
- Is this issue about more than solely what is legal or what is most efficient? If so, how?

Get the Facts

- What are the relevant facts of the case? What facts are not known? Can I learn more about the situation? Do I know enough to make a decision?
- What individuals and groups have an important stake in the outcome? Are the concerns of some of those individuals or groups more important? Why?
- What are the options for acting? Have all the relevant persons and groups been consulted? Have I identified creative options?

Evaluate Alternative Actions

Evaluate the options by asking the following questions:

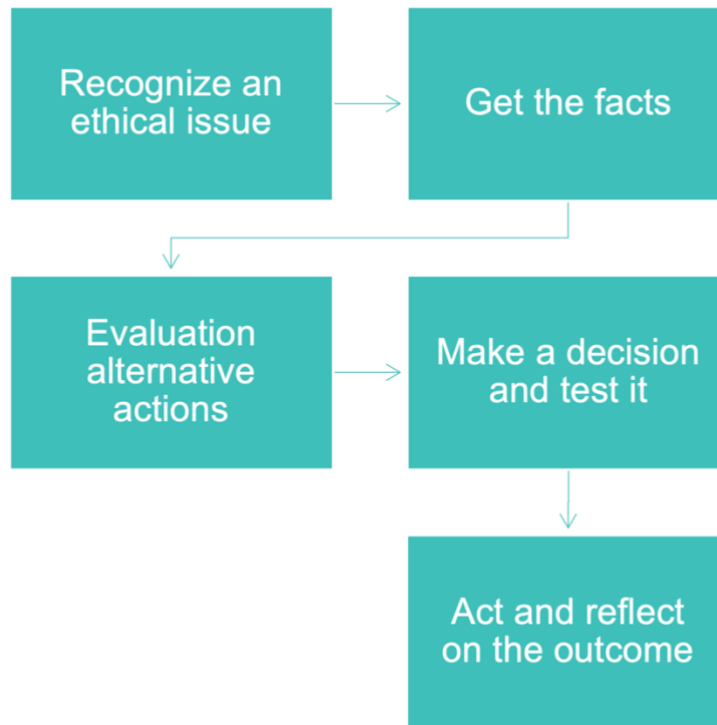
- Which option best respects the rights of all who have a stake? (The Rights Lens)
- Which option treats people fairly, giving them each what they are due? (The Justice Lens)
- Which option will produce the most good and do the least harm for as many stakeholders as possible? (The Utilitarian Lens)
- Which option best serves the community as a whole, not just some members? (The Common Good Lens)
- Which option leads me to act as the sort of person I want to be? (The Virtue Lens)
- Which option appropriately takes into account the relationships, concerns, and feelings of all stakeholders? (The Care Ethics Lens)

Choose an Option for Action and Test It

- After an evaluation using all of these lenses, which option best addresses the situation?
- If I told someone I respect (or a public audience) which option I have chosen, what would they say?
- How can my decision be implemented with the greatest care and attention to the concerns of all stakeholders?

Implement Your Decision and Reflect on the Outcome

- How did my decision turn out, and what have I learned from this specific situation? What (if any) follow-up actions should I take?



CASE STUDY 4:

Insider Trading

Press Release from the Department of Justice, U.S. Attorney's Office, District of New Jersey

Wednesday, June 22, 2022

Former Head of Corporate Communications of \$21 Billion Biopharmaceutical Company Admits Insider Trading

NEWARK, N.J. – The former head of corporate communications for a biopharmaceutical company today admitted her role in an insider trading scheme, U.S. Attorney Philip R. Sellinger announced.

Lauren S. Wood, 33, of Washington, D.C., pleaded guilty before U.S. District Judge John Michael Vazquez to an information charging her with securities fraud. Stemming from the same alleged conduct, Usama Malik, also of Washington, D.C., was previously charged in a three-count indictment with insider trading, securities fraud, and securities fraud conspiracy.

According to documents filed in this case and statements made in court:

From 2018 through October 2020, Malik was the chief financial officer (CFO) of a New Jersey-based biopharmaceutical company listed on the NASDAQ Stock Exchange. On April 6, 2020, the company publicly announced for the first time that its breast cancer drug – an antibody-based drug designed to treat certain breast cancer patients who had very limited treatment options beyond chemotherapy – had proven effective in pre-market clinical trials. In October 2020, another biopharmaceutical company acquired the company for which Malik worked for approximately \$21 billion.

Malik was among the first, and one of the few, employees who received the material non-public information about the breast cancer drug before the public announcement. Within minutes of obtaining that information, Malik passed it along to Wood, who lived with Malik at the time and was formerly employed by the same company. Before April 6, 2020, and within hours of receiving the insider information from Malik, Wood placed an order for approximately 7,000 shares of the company's stock, despite the fact that during the same time period the company's stock was downgraded by financial experts. After the company announced that its cancer drug had proven effective in pre-market clinical trials, its stock price increased. After selling her shares, Wood more than doubled her investment, realizing gross profits of \$213,618.

The securities fraud charge to which Wood pleaded guilty carries a potential penalty of 20 years in prison and a \$5 million fine. Sentencing is scheduled for Nov. 21, 2022.

The U.S. Securities and Exchange Commission (SEC) also filed a civil complaint on Dec. 1, 2021 based on the same conduct.

The charges and allegations against Malik are merely accusations, and he is presumed innocent unless and until proven guilty.

CASE UPDATE

On May 17, 2023, Usama Malik pleaded guilty of an indictment charging him with securities fraud/insider trading. (Read the [press release](#) from Department of Justice, Office of Public Affairs.)

According to [The Business Journals](#), in September 2023 Malik was sentenced to three years of probation, six months of house arrest, 400 hours of community service and fines totaling \$15,000.

Lauren S. Wood was sentenced to three years of probation and ordered to repay \$67,000, according to [Law360](#).

The PLUS Model

Like the AICPA Conceptual Framework, which offers a principles-based approach to ethics, other methodologies also exist to assist in ethical decision-making. The Ethics & Compliance Initiative (ECI) is a best-practice community of organizations committed to creating and sustaining high quality ethics and compliance programs. ECI offers a seven-step decision-making model that can be leveraged in assessing risks.

Step 1: Define the Problem

Defining the problem requires an individual to identify the issue at hand and investigate the difference between expectations or desired outcomes versus present conditions. It is important to identify the true problem and not a symptom of the problem.

Step 2: Seek Out Relevant Guidance

Individuals can look to professional guidance or internal and external policies to determine the best course of action.

Step 3: Identify Alternatives

Identifying alternatives requires the individual to formulate as many potential ways to solve the problem as possible. A larger number of answers can be identified by not just looking to the obvious answer but keeping an open mind to all possibilities.

Step 4: Evaluate Alternatives

This step requires considering the pros and cons of the various alternatives. An individual must consider both the impact and its likelihood while carefully assessing each option.

Step 5: Make the Decision

Given the information identified in Step 4, here the individual selects the alternative that provides the best overall outcome.

Step 6: Implement the Decision

Decision-making and implementation are two different things. The key to implementing the decision is taking decisive action on the alternative selection.

Step 7: Evaluate the Decision

With any major decision, a feedback loop is very important. After implementation, Step 7 allows the individual to step back and determine how the alternative implemented ultimately fared. Making a decision without a lookback process does not allow the individual to consider how the alternative selected ultimately impacted the situation.

ECI also offers a filter that can be used in steps 1, 4 and 7.

P = Policies

Is it consistent with my organization's policies, procedures and regulations?

L= Legal

Is it acceptable under the applicable laws and regulations?

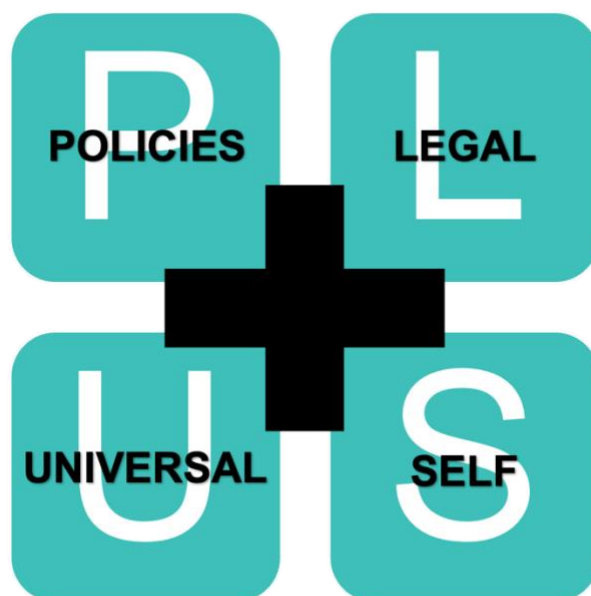
U = Universal

Does it conform to the universal principles/values my organization has adopted?

S= Self

Does it satisfy my personal definition of right, good and fair?

This decision-making model dovetails well with the threats-and-safeguards approach by allowing you to think outside the box and consider alternatives as part of the ethics process.



CASE STUDY 5:

Startup Fraud

Press release from the Department of Justice, U.S. Attorney's Office, Northern District of California

Tuesday, January 4, 2022

Theranos Founder Elizabeth Holmes Found Guilty Of Investor Fraud

Jury Concludes Holmes Perpetrated Scheme To Defraud Investors

SAN JOSE - A jury found Elizabeth A. Holmes guilty of one count of conspiracy and three counts of wire fraud in connection with a multi-million-dollar scheme to defraud investors in Theranos, Inc., announced United States Attorney Stephanie M. Hinds; Federal Bureau of Investigation (FBI) Special Agent in Charge Craig D. Fair; Food and Drug Administration (FDA) Acting Commissioner Janet Woodcock; and U.S. Postal Inspection Service (USPIS) Inspector in Charge Rafael Nuñez. The verdicts follow a 15-week trial before the Honorable Edward J. Davila, United States District Judge.

"The jurors in this 15-week trial navigated a complex case amid a pandemic and scheduling obstacles," said U.S. Attorney Hinds. "I thank the jurors for their thoughtful and determined service that ensured verdicts could be reached. The guilty verdicts in this case reflect Elizabeth Holmes' culpability in this large-scale investor fraud and she must now face sentencing for her crimes."

"Elizabeth Holmes chose fraud over business failure. A jury has determined, beyond a reasonable doubt, that she intentionally misled investors," said Special Agent in Charge Craig Fair. "I want to thank the FBI San Francisco agents and analysts who spent years investigating allegations of fraud within Theranos to uncover the truth and ensure justice in this case."

"The FDA's Office of Criminal Investigations (OCI) will continue to investigate and help bring to justice individuals and companies responsible for putting the public health at risk," said FDA Assistant Commissioner for Criminal Investigations Catherine A. Hermesen. "FDA-OCI is proud to have partnered with the United States Attorney's Office and its law enforcement counterparts to bring this prosecution."

"The U.S. Postal Inspection Service is committed to protecting consumers and investors from fraud," said USPIS Inspector in Charge Nuñez. "We are proud of the dedication shown by Postal Inspectors and our partners at the U.S. FDA and the FBI by seeing this case through to a verdict."

Holmes, 37, of Woodside, Calif., founded Theranos in 2003. Theranos was a blood testing company based in Palo Alto and Newark, Calif. Holmes used a combination of direct communications, marketing materials, statements to the media, financial statements, models, and other information to induce investments. She claimed Theranos had developed an analyzer, variously referred to as, among other things, the Theranos Sample Processing Unit (TSPU), Edison, or minilab. She claimed the analyzer was able to perform a full range of clinical tests using small blood samples drawn from a finger stick. She also represented that the analyzer could produce results that were more accurate and reliable than those yielded by conventional methods—all at a faster speed than previously possible.

The evidence submitted during the trial demonstrated Holmes knowingly made materially false representations to investors and potential investors about the analyzer. For example, the evidence showed that Holmes knew the analyzer had accuracy and reliability problems, performed a limited number of tests, was slower than some competing devices, and, in some respects, could not compete with existing, more conventional machines. Evidence also showed that Holmes resorted to using conventional machines bought from third parties to perform much of Theranos's blood testing.

The trial included evidence that Holmes made numerous misrepresentations to potential investors about Theranos's financial condition and its future prospects. For example, the evidence showed that Holmes represented to investors that Theranos would generate over \$100 million in revenues and break even in 2014 and that Theranos expected to generate approximately \$1 billion in revenues in 2015 when, in truth, she knew Theranos would generate only negligible or modest revenues in 2014 and 2015.

Further, the evidence showed that Holmes represented to investors that Theranos had a profitable and revenue-generating business relationship with the United States Department of Defense and that Theranos's technology had deployed to the battlefield when, in truth, Theranos had limited revenue from military contracts and its technology was not deployed in the battlefield. The evidence showed Holmes represented to investors that Theranos had been comprehensively validated by numerous major pharmaceutical companies and provided reports to investors with logos from pharmaceutical companies falsely suggesting the pharmaceutical companies endorsed Theranos. In addition, the evidence showed that Holmes represented to investors that Theranos would soon dramatically increase the number of Wellness Centers within Walgreens stores even though Theranos's retail Walgreens rollout had stalled because of several issues.

The jury convicted Holmes of the investor wire fraud conspiracy count and three substantive wire fraud counts relating to the scheme to defraud investors, including wire transfers totaling more than \$140 million. The jury acquitted Holmes of the patient-related conspiracy wire fraud count and three additional wire fraud counts. One count of wire fraud relating to a Theranos patient was dismissed during the trial. The jury could not reach a unanimous verdict with respect to three investor fraud-related counts.

Holmes faces a maximum sentence of twenty (20) years in prison, and a fine of \$250,000, plus restitution, for the conspiracy count and each count of wire fraud. However, any sentence following conviction would be imposed by the court after consideration of the U.S. Sentencing Guidelines and the federal statute governing the imposition of a sentence, 18 U.S.C. § 3553.

Judge Davila has not yet scheduled Holmes's sentencing hearing. She remains free on bond, pending further hearings.

CASE UPDATE

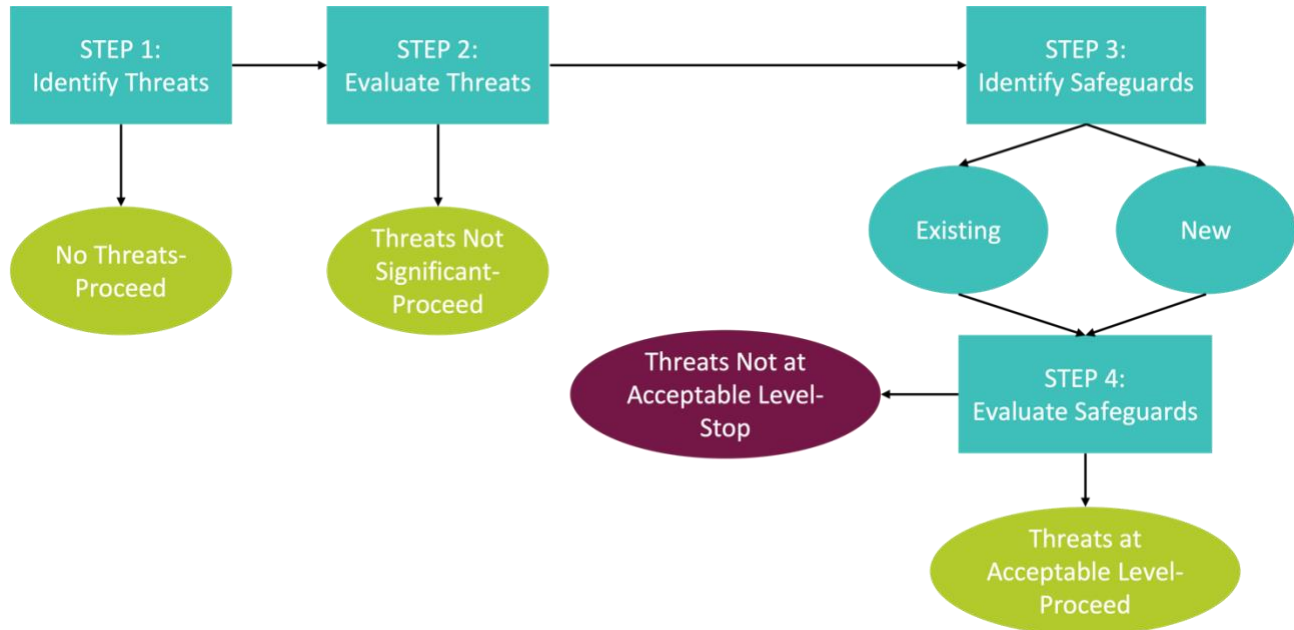
According to the [Department of Justice](#), Holmes was sentenced on Friday, November 18, 2022 to 135 months (11 years, 3 months) in federal prison for defrauding investors in Theranos, Inc. of hundreds of millions of dollars.

In addition to the prison term, U.S. District Judge Davila sentenced Holmes to three years of supervision following release from prison. The parties were instructed to meet and agree on a future date for a hearing to determine the restitution amount to be paid by Holmes. No fine was assessed. Holmes was ordered to surrender on April 27, 2023, to begin serving her prison sentence.

AICPA Conceptual Framework Approach

The AICPA provides a conceptual framework that can be applied when assessing decision-making in a particular situation. The conceptual framework approach recognizes that there cannot possibly be a rule to address every conceivable situation and provides a formalized process through which to apply professional judgment that may be required.

The following are the steps of the conceptual framework:



1. The first step is to identify threats. Ask yourself, “Does this relationship or circumstance create a threat?” If yes, the significance of the threat needs to be evaluated in the second step.
2. In the second step, evaluate threats. Ask yourself whether or not the threat is at an acceptable level. A threat is at an acceptable level when a reasonable, informed third party who is aware of the relevant information would be expected to conclude that the threat is at an acceptable level. Consider both qualitative and quantitative factors when evaluating the significance of a threat. If you conclude that the threat is not at an acceptable level, then you need to proceed to the third step.
3. The third step is to identify safeguards. Ask yourself what safeguards are in place or could be put in place. When identifying safeguards, remember that one safeguard might eliminate or reduce several threats. However, it might also be necessary to identify several safeguards to eliminate or reduce just one threat. After you have identified new and existing safeguards, proceed to the fourth step.
4. In the fourth step, evaluate safeguards. Ask yourself if the safeguards eliminate or reduce the threat to an acceptable level.

APPENDIX I: Acronyms & Glossary

Association of Certified Fraud Examiners (ACFE) is the world's largest anti-fraud organization and premier provider of anti-fraud training and education.

Affiliate of a financial statement attest client is any of the following entities:

- a. An entity (for example, subsidiary, partnership or limited liability company) that a financial statement attest client can control.
- b. An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that give the financial statement attest client significant influence over such entity and that is material to the financial statement attest client.
- c. An entity (for example, parent, partnership or limited liability company) that controls a financial statement attest client when the financial statement attest client is material to such entity.
- d. An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.
- e. A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.
- f. A trustee that is deemed to control a trust financial statement attest client that is not an investment company.
- g. The sponsor of a single employer employee benefit plan financial statement attest client.
- h. Any entity, such as a union, participating employer, or a group association of employers, that has significant influence over a multiemployer employee benefit plan financial statement attest client and the plan is material to such entity.
- i. The participating employer that is the plan administrator of a multiple employer employee benefit plan financial statement attest client.
- j. A single or multiple employer employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.
- k. A multiemployer employee benefit plan when a financial statement attest client or entity controlled by the financial statement attest client has significant influence over the plan and the plan is material to the financial statement attest client.
- l. An investment adviser, a general partner, or a trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

Source: AICPA Professional Ethics Committee October 2015 Official Release

Assurance means any form of expressed or implied opinion or conclusion about the conformity of a financial statement with any recognition, measurement, presentation or disclosure principles for financial statements.

Attest services means audit, review or other attest services for which standards have been established by the Public Company Accounting Oversight Board (PCAOB), by the Auditing Standards Board or the Accounting and Review Services Committee of the American Institute of CPAs (AICPA), or by any successor standard-setting authorities.

Benford's Law is a law in statistics. This law describes how, in any given collection of numbers being studied, more of them will be likely to start with a 1 than any other number. 2's will appear at the beginning less often, 3's still less, and so on, at a predictable rate.

Client means any person or entity, other than a CPA's employer, that engages a CPA or CPA firm to perform professional services (engaging entity) and also a person or entity with respect to which a CPA or CPA firm perform professional services (subject entity). When the engaging entity and the subject entity are different, while there is only one engagement, they are separate clients. *Source: AICPA Professional Ethics Committee December 2017 Official Release*

Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of five professional organizations and is dedicated to helping organizations improve performance by developing thought leadership that enhances internal control, risk management, governance and fraud deterrence.

Compilation services means compiling financial statements in accordance with standards established by the AICPA or by any successor standard-setting authorities.

Conformity refers to the degree to which state tax codes conform to the federal tax code.

Cybersecurity means how a company protects itself against unauthorized use or access to electronic data.

Ethical communication means communication that furthers integrity and builds trust based on the idea of congruent words and actions.

Financial statement means a presentation of *historical or prospective* information about one or more persons or entities.

Financial reporting framework (FRF) are the standards used to measure, recognize, present and disclose all material items within an entity's financial statements. Examples include U.S. Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS) and special purpose frameworks.

Financial Reporting Framework for Small-and-Medium-sized Entities (FRF-SME) is a principles-based special purpose framework for preparing financial statements of privately held small- to medium-sized entities. It was developed under the guidance of the AICPA FRF for SMEs task force and is therefore non-authoritative.

Fraud risk management is the responsibility of the board of directors and top management and personnel at all levels of an organization. It includes understanding how the organization is responding to heightened risks and regulations, as well as public and stakeholder scrutiny; what form of Fraud Risk Management Program the organization has in place; how it identifies fraud risks; what it is doing to better prevent fraud, or at least detect it sooner; and what process is in place to investigate fraud and take corrective action.

Hosting services are nonattest services that involve a CPA accepting responsibility for the following:

- a. Acting as the sole host of a financial or non-financial information system of an attest client
 - b. Taking custody of or storing an attest client's data or records whereby, that data or records are available only to the attest client from the member, such that the attest client's data or records are otherwise incomplete
 - c. Providing electronic security or back-up services for an attest client's data or records
- Source: AICPA Professional Ethics Committee August 2017 Official Release*

Independence consists of two elements, defined as follows: a. Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism. b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

Licensee means a person or firm holding a Virginia license or the license of another state. However, for purposes of this document, licensee only refers to a person holding a Virginia license or the license of another state.

Mobility means a practice privilege that generally permits a licensed CPA in good standing from a substantially equivalent state to practice outside of his or her place of business without obtaining another license. *Source: cpamobility.org*

Online presence means how we appear to clients, employers, colleagues, family, friends, the profession and the public at large on the Internet. It is the collective picture we present to the public through social media, blogs, websites and other Internet sources.

Owner-managed entities are closely held companies run by the individuals who own a controlling ownership interest; a stark contrast to public companies, which by definition have an obvious separation between ownership and the management.
Source: AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQ

Peer review means one of two types of reviews (system and engagement) of a firm's accounting and auditing practice conducted in accordance with the AICPA's practice monitoring program. A system review is a study and appraisal by an independent evaluator of a CPA firm's system of quality control to perform accounting and auditing work. An engagement review is a study and appraisal by an independent evaluator of a sample of a CPA firm's actual accounting work, including accounting reports issued and documentation prepared by the CPA firm, as well as other procedures that the firm performed.

Practice of public accounting means the giving of an assurance other than (i) by the person or persons about whom the financial information is presented or (ii) by one or more owners, officers, employees or members of the governing body of the entity or entities about whom the financial information is presented.

Professional skepticism is an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

Providing services to the public means providing services that are subject to the guidance of the standard-setting authorities listed in the standards of conduct and practice in subdivisions 5 and 6 of § 54.1-4413.3.

§ 54.1-4413.3. Standards of conduct and practice. (5 and 6 only listed below.)

5. Follow the technical standards, and the related interpretive guidance, issued by committees and boards of the American Institute of Certified Public Accountants that are designated by the Council of the American Institute of Certified Public Accountants to promulgate technical standards, or that are issued by any successor standard-setting authorities.
6. Follow the standards, and the related interpretive guidance, as applicable under the circumstances, issued by the Comptroller General of the United States, the Federal Accounting Standards Advisory Board, the Financial Accounting

Standards Board, the Governmental Accounting Standards Board, the Public Company Accounting Oversight Board, the U. S. Securities and Exchange Commission, comparable international standard-setting authorities, or any successor standard-setting authorities.

Providing services to an employer means providing to or on behalf of an entity services that require the substantial use of accounting, financial, tax or other skills that are relevant, as determined by the Board.

Safeguards mean controls that eliminate or reduce threats. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguard to be applied depend on many factors. To be effective, safeguards should eliminate or reduce the threat to an acceptable level.

Source: AICPA Code of Professional Conduct

Small- and medium-sized entities (SME). There is no standard definition in the United States or under the AICPA.

Source: AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQ

Special purpose framework means a financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
 - b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
 - c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
 - d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
 - e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.
- The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as other comprehensive bases of accounting.

Source: AICPA Clarified Statement on Auditing Standards (AU-C) 800

Substantial equivalency means that the education, CPA exam and experience requirements contained in the statutes and administrative rules of another jurisdiction are comparable to, or exceed, the education, CPA exam and experience requirements contained in Chapter 44 of Title 54.1 of the Code of Virginia and the Board of Accountancy Regulations. (18VAC5-22).

Threat means a circumstance that could compromise compliance with the rules. A threat is at an acceptable level if a reasonable and informed third party who is aware of the relevant information would be expected to conclude that compliance with the rules is not compromised. If the threat is not at an acceptable level, specific safeguards should be applied to reduce or eliminate the threat and the effectiveness of those safeguards should be evaluated.

Source: AICPA Code of Professional Conduct

Transparency means the quality that makes something obvious or easy to understand.

Trusted advisor means someone who gives advice in which confidence is placed due to reliance on the character, ability, strength, and truthfulness of that advisor.

Using the CPA title in Virginia means using “CPA,” “Certified Public Accountant” or “public accountant” (i) in any form or manner of verbal communication to persons or entities located in Virginia or (ii) in any form or manner of written communication to persons or entities located in Virginia, including but not limited to the use in any abbreviation, acronym, phrase or title that appears in business cards, the CPA wall certificate, Internet postings, letterhead, reports, signs, tax returns or any other document or device. Holding a Virginia license or the license of another state constitutes using the CPA title.

Whistleblower means one who reveals something covert or who informs against another, especially an employee who brings wrongdoing by an employer or by other employees to the attention of a government or law enforcement agency. A whistleblower is commonly protected legally from retaliation.

APPENDIX II: References & Resources

PPP Fraud Scheme Case Study

[Man Convicted for \\$27 Million PPP Fraud Scheme | OPA | Department of Justice](#)

"Man convicted for \$27 million PPP Fraud scheme." The United States Department of Justice. (2022, March 29). <https://www.justice.gov/opa/pr/man-convicted-27-million-ppp-fraud-scheme>

An Extensive Timekeeping Fraud Case Study

[Former DoD Employee Sentenced to Prison for \\$1.4 Million Fraud Scheme | USAO-EDVA | Department of Justice](#)

"Former DOD Employee Sentenced to Prison for \$1.4 Million Fraud Scheme." The United States Department of Justice. (2019, March 13). <https://www.justice.gov/usao-edva/pr/former-dod-employee-sentenced-prison-14-million-fraud-scheme>

Society of Human Resources Ethical Culture Model

[Shaping an Ethical Workplace Culture \(shrm.org\)](#)

Originally published as "Shaping an Ethical Workplace Culture." ©2013 the SHRM Foundation, Alexandria, Va. Used with permission. All rights reserved.

SHRM Foundation. (2013). *Shaping An Ethical Workplace Culture*. SHRM. <https://www.shrm.org/hr-today/trends-and-forecasting/special-reports-and-expert-views/Documents/Ethical-Workplace-Culture.pdf>

Cryptocurrency Investment Scheme Case Study

[Director and promoter of BitConnect pleads guilty in global \\$2 billion cryptocurrency scheme | Internal Revenue Service \(irs.gov\)](#)

"Director and Promoter of BitConnect Pleads Guilty in Global \$2 Billion Cryptocurrency Scheme | Internal Revenue Service." (2022, August 10) www.irs.gov/compliance/criminal-investigation/director-and-promoter-of-bitconnect-pleads-guilty-in-global-2-billion-cryptocurrency-scheme.

Santa Clara University Framework for Ethical Decision Making

[A Framework for Ethical Decision Making - Markkula Center for Applied Ethics \(scu.edu\)](#)

University, Santa Clara. "A Framework for Ethical Decision Making." *A Framework for Ethical Decision Making - Markkula Center for Applied Ethics*, 8 Nov. 2021, www.scu.edu/ethics/ethics-resources/a-framework-for-ethical-decision-making.

Insider Trading Case Study

[Former Head of Corporate Communications of \\$21 Billion Biopharmaceutical Company Admits Insider Trading | USAO-NJ | Department of Justice](#)

"Former Head of Corporate Communications of \$21 Billion Biopharmaceutical Company Admits Insider Trading." 22 June 2022, www.justice.gov/usao-nj/pr/former-head-corporate-communications-21-billion-biopharmaceutical-company-admits-ins

The PLUS Model

[The PLUS Ethical Decision Making Model - Ethics & Compliance Toolkit](#)

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The Ethics & Compliance Initiative. (2021, October 25). *The PLUS Ethical Decision Making Model - Ethics & Compliance Toolkit*. Ethics and Compliance Initiative. <https://www.ethics.org/resources/free-toolkit/decision-making-model/?highlight=plus%20model>.

Startup Fraud Case Study

[Theranos Founder Elizabeth Holmes Found Guilty Of Investor Fraud | USAO-NDCA | Department of Justice](#)

“Theranos Founder Elizabeth Holmes Found Guilty of Investor Fraud.” *Northern District of California | Theranos Founder Elizabeth Holmes Found Guilty of Investor Fraud | United States Department of Justice*, 4 Jan. 2022, www.justice.gov/usao-ndca/pr/theranos-founder-elizabeth-holmes-found-guilty-investor-fraud.

AICPA Conceptual Framework Approach

[AICPA Conceptual Framework Approach](#)

“AICPA Conceptual Framework Approach.” *AICPA*, www.aicpa.org/interestareas/professionalethics/community/aicpa-conceptual-framework.html.