

Phar mor inc case study

Business



Sean Russi The Case of Phar-Mor Inc ACCT-525 October 31, 2012 Case Summary The case of Phar-Mor Inc was one of the biggest pre-Enron frauds that have been uncovered. Phar-Mor Inc established in 1982 Phar-Mor was a small little known discount drugstore. Phar-Mor became well known for offering medications at a 25-40% discount rate compared to your normal pharmacy store prices. Phar-Mor's first six years of existence seemingly were fraud free and saw the company grow at a decent pace for their field.

By 1987 Phar-Mor almost had 100 stores and was expanding even more rapidly at this point.

The first hint of fraud came up and was discovered being a billing type scheme involving un-received inventory. On top of which it was not policy at the time for Phar-Mor to keep receiving records so there was no way to track it back to the company supposedly shipping in the inventory. The inventory incident ended up costing Phar-Mor seven million dollars and instead of reporting a nine million dollar profit they reported a two million dollar profit. The other problem that Phar-Mor was suffering from unknown to most of the top staff at the company and investors was the President Michael J.

Monus had invested in the World Basketball League and was a 60% owner of the WBL. The problem was Monus was losing over seven thousand dollars per night the league was in operation so to cover losses Monus was taking money from Phar-Mor to cover the WBL losses. On top of that Monus had also taken out 200, 000 dollars to improve his personal home. Phar-Mor was able to cover up the losses by using what they considered a " bucket account" and would move all fraudulent activities thru that account because

they were aware that the auditors would not look at any account that had a zero balance.

So by moving fraudulent activity thru this “ bucket account” the other accounts showed zero balances and the auditors didn’t bother to look any further than that. In the end of the company in 1992 when Phar-Mor finally filed for bankruptcy was about a year after one of their own Account heads finally uncovered the fraud in 1991 and blew the whistle on the company.

At the time of discovery Phar-Mor was overstated by over a \$150 million dollars and had no other choice but to file bankruptcy. Could SOX have prevented the Phar-Mor fraud?

How? Which specific sections of SOX? During the time period that the Phar-Mor fraud took place it was one of the most elaborate frauds of the 1980’s so could SOX prevented the fraud? The answer is debatable because of the extent that Phar-Mor went to cover up the fraud it may have taken several years still to uncover it however, in the long run I do believe SOX would have prevented the fraud from lasting almost a full decade without being detected, and would not have been uncovered had it not been for a whistle blower.

I think the most important sections of SOX that would have helped uncover the fraud at Phar-Mor are as follows - Section 203 - Which deals with the auditors and any possible conflict of interest if they had worked with Phar-Mor in the last calendar year they would have not been able to be the same auditors doing final audits of the company. - Section 206- Which states that

any auditor who had previously worked for the firm and now works for Phar-Mor would cause the firm to not be able to have Phar-Mor as a client.

Phar-Mor had 3 former employees of the audit firm who worked for them which allowed them the knowledge to know that the auditors wouldn't check for certain items and certain accounts if they showed zero balance. – Section 404 – Which requires that the internal controls to be assessed and tested once per fiscal year.

This would have helped the fraud be uncovered much sooner because the auditors would have checked over the inventory procedures and the fraud would have been discovered years earlier. Research the Waste Management scandal from the late 1990's. Describe the scandal.

Could SOX have prevented this scandal? The Waste Management scandal of the 1990's was one of a common type of fraud that has been seen time and again over the last two decades. The Waste Management scandal was one where performance based pay was being used so executives based on the company's bottom line got bonus's, stock options, and higher salaries. The executives then in turn sold those stock options right before the bottom fell out making millions of dollars on the stocks.

The company's investors lost a total 6 billion dollars due to the fraud one of the biggest losses to date at that time.

The problem within the scandal was that Arthur Andersen had provided the CEO's with steps to cover up the SEC regulations that the company was breaking (St. Pete Times, 2002). In this instance SOX again could have helped at least eventually discover the fraud but it would appear on the <https://assignbuster.com/phar-mor-inc-case-study/>

surface to be more in-depth than the Phar-Mor fraud. Now one of the things SOX would have stopped was during the course of the 1990's at least 14 employees worked for both Andersen and the Waste Management Company.

That would have violated SOX conflict of interest and maybe would have deterred the fraud. Research the Enron scandal from the early 2000's. Describe the scandal. Could SOX have prevented this scandal? The Enron scandal is one of if not the most well known fraud of the current time. Enron's fraud is one of the main reasons SOX was put into place.

The Enron scandal was one of cooking the books which allowed Enron to drive up their stock prices and just like the Waste Management scandal allowed executives to collect high salaries and incentive based bonus's.

Enron was a walking conflict of interest the CFO also ran Enron's subsidiaries and the CEO, President, and CFO all sat on the board of Enron. This is what allowed the fraud to run so smoothly for so many years. The other issue was Enron turned a blind eye when their employee's also started to break SEC regulations in regards to stock trade, and manipulation. SOX could have easily prevented Enron one if would have occurred after the Waste Management scandal so Arthur Andersen would have never been able to be involved with the Enron Company.

There was countless conflict of interest and lack of internal controls at Enron which also would have been deterred and subsided by SOX.

In closing SOX could have stopped or deterred many frauds fact of the matter SOX was not around during the three aforementioned fraud cases.

However, since its enactment while fraud still does take place the

percentage and elaborate frauds like Enron, Madoff, and Phar-Mor have dramatically decreased and hopefully will continue to do so.