NORTHERN ILLINOIS UNIVERSITY

William Stoecker/Grabill Corporation and Laventhal and Horwath:

Bankruptcy of a man, his company, and his auditors.

A Thesis submitted to the University Honors Program
In Partial Fulfillment of the Requirements of the Baccalaureate Degree

With University Honors
Department of Accountancy

by

James J. Lipinski

DeKalb, Illinois

May, 1989
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ABSTRACT (100-200 WORDS:) This project explains the bankruptcies of Grabill Corporation, and Laventhol & Horwath (a major accounting firm).

William Stoecker formed Grabill Corporation to rehab and resell houses. Grabill Corporation would later start buying operating companies with borrowed money. William Stoecker and his Grabill Corporation eventually borrowed about three-quarters of a billion dollars. Grabill was not financially sound, but they had financial statements audited by Laventhol & Horwath that indicated otherwise. An article in Forbes magazine cast doubt on Stoecker's claims. This made his banks nervous, and they refused to loan him additional funds. With no additional funds, Stoecker missed a loan payment and was forced into bankruptcy.

This project discusses Grabill Corporation as an example of the poor audit work done by Laventhol & Horwath that led them too into bankruptcy. Laventhol's problems stemming from their overly quick growth and other audit lawsuits are discussed to show the various factors leading to Laventhol's bankruptcy.

Finally, the thesis concludes by drawing a number of conclusions about the condition of today's accounting industry and what accountants can do to minimize their inclusion in lawsuits from failed businesses.
Approved:  Centers Norton

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CHAPTER 1
INTRODUCTION

William Stoecker at first seemed to be a hugely successful entrepreneur. By the time he was 30, he had borrowed enough money to make him look like "Chicago's version of Donald Trump," and his accountants had figured he had enough money to make him one of the 200 richest people in America.¹

His entrepreneurial talent, however, lied in the fact that he is what many have referred to as "a natural con man."² He faced the nation's leading financial institutions and came away with what would amount to about a half a billion dollars in loans. The catch is that Mr. Stoecker wasn't making money to pay off these loans, but rather he was paying off the loans with new loans. His methods were similar to a sophisticated check kiting scheme.

One naturally wonders how he could get away with half a billion dollars in loans if his companies were not making the kind of money needed to support these loans. Part of the reason is that Bill Stoecker is a very persuasive man and knew how to "cloud a banker's vision, stun his mind, [and] open the vaults."³ When his charm alone was no longer enough, he hired the

¹ Gelber, "Whiz Kid," p. 3.
³ Ibid.
accounting firm of Laventhol & Horwath to certify his financial statements.

Stoecker and his Grabill Corp. were able to acquire millions of dollars in loans based on financial statements audited by Laventhol & Horwath which reported assets at greatly inflated values and which reported subsidiaries, which did not even exist, at millions of dollars each. The Grabill case will be discussed in detail as a prime example of the type of clients and sloppy or fraudulent audit work that led to Laventhol's demise. This paper will also briefly detail the other problems Laventhol was having that contributed to their eventual bankruptcy. Finally, current conditions in the accounting industry will be looked at in an attempt to show that Laventhol's plight is somewhat a sign of the times.
CHAPTER 2

WILLIAM STOECKER AND HIS GRABILL CORPORATION

**Stoecker's Background.**

William Stoecker, who was the chairman and sole shareholder of Grabill corporation, grew up in Oak Forest, Illinois. Oak Forest is a small town which is about 20 miles southwest of Chicago's Loop. Stoecker was the only surviving son in a devout Catholic family of eight. He attended St. Damian's grade school where he was an altar boy on Sundays. Stoecker also attended Oak Forest High School where he played football and basketball for two years. Stoecker started working in his father's fencing business at the age of eleven and earned money which reportedly made him a big spender among his friends. When Stoecker was only sixteen and most of his friends were shoveling snow, he organized a team of snow plows. Finally, he had set up a welding operation in which he was earning $100,000 a year by the time he was twenty.

In the late 1970's, Stoecker dropped out of Moraine Valley Community College after just one semester. His plan was to borrow money to fix up homes on which banks had foreclosed. In 1980 or 1981 he had accompanied his father out to the south suburban town of Frankfort to see an abandoned house he was going

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to buy. The house had holes in its walls big enough for a person to walk through. It had been vandalized and there were animal carcasses lying on the buckling floors. Stoecker told his dad that he had been reading "those books that tell you how to make a million dollars in real estate in three years." Stoecker said to his father, "I'm on my way." The reaction he got from his father came as a surprise. His father, Frank Stoecker, was a very religious man (who had studied for the priesthood), and Stoecker said he had never before heard his father swear. However, upon seeing this house, his father said to him "You know, you're an asshole. I'm not gonna be able to talk any sense into you."  

**Grabill Corp. Begins Business.**

Despite his father's disapproval, Stoecker began to buy houses that the banks had foreclosed on. In 1981, he founded Grabill Corporation. (The name Grabill is a combination of the names "Grace" and "Bill". Grace was Stoecker's wife whom he had married in 1982.) In four years (1980-1984), Stoecker claimed that his corporation had earned $70 million by rehabbing houses and selling them at a profit. Stoecker learned that he could buy houses without using any of his own money. He was obtaining 100 percent financing or more from thrifts or banks on foreclosed Chicago residential homes. The situation in the distressed real estate market in the late '70s made savings and loans so eager to get bad loans off their books that they would cut prices and give Stoecker 110 percent financing (with the extra going into the

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7 Silberman, "The Fall of the House of Stoecker," p. 177.
rehabilitations). It occurred to Stoecker, "If you could buy houses with borrowed money, why not also buy companies with borrowed money?"

The midwest economy in the early '80s was in pretty bad shape, and Stoecker began to use borrowed money to purchase undercapitalized companies and then fund their growth. The midwest area in which Stoecker was buying up operating companies is sometimes referred to as the Rust Belt. Stoecker would later explain, "There's a rich little vein of manufacturing companies out there[.] We discovered them before middle-market lending became the rage. Now we look like geniuses."

So, in 1984, he began to buy operating companies. His first purchases were Midway Cap Company of Chicago which he purchased for $1 million and North Star Van & Storage of Milwaukee which he purchased for $800,000. Between 1984 and 1987 he acquired 29 additional companies including Fulton Market Cold Storage, Allied Die Casting, Detroit Armor, and Cook's Cupboard. Eventually, his largest purchase was that of the aerospace operations of Fruehauf Corp., which he renamed Grabill Aerospace Industries.

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8 Elsner and Sly, "Grabill case: Matter of fraud or ineptitude?" p. 5.
10 King, "Love Those Gullible Bankers," p. 79.
11 Ibid. p. 78.
Stoecker wanted Grabill Corporation to be a diverse conglomerate. He would leave the companies' managements intact and leave operations decentralized. He stated, "The only change in a company after I bought it was that instead of making obscene profits, it would make obscene loan payments." When it all came down to the end, Stoecker had built a corporate empire which had 31 operating companies.

The Life of a Millionaire.

The Grabill headquarters were constructed at 150th and Cicero in Oak Forest. There were three buildings which were two- and three-story brown brick structures. Their purpose: to communicate to the bankers "Grabill's propriety, stability and wealth." Visitors to the Grabill complex would enter the elevator in what would appear to be a common suburban office center, but when they stepped off the elevator, the scene was 18th century England. The Grabill office center was decorated with an art collection consisting of 300 pieces of 18th century art and artifacts. There were original works by Gainsborough, Turner, Rossetti, and Stubbs. The collection also contained Lord Nelson's strong box, and silver flatware that Napoleon had given his sister as a wedding gift. Lenders were flown in and out via a corporate helicopter and were given a tour of the incredible Grabill complex with its magnificent art collection. They were wined and dined by Stoecker's personal chef in the executive suite.

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dining room which sported silk walls and an antique Persian carpet. The deals were then closed in the boardroom or in front of the marble fireplace in the suite.\textsuperscript{15}

Stoecker's homes were all very impressive too. He bought up three homes in Palos Park at 12413-12419 Hobart Avenue (which would later be on the market for 1.85 million).\textsuperscript{16} The main house had four bedrooms and was done in a French country style, which Stoecker and his wife had personally selected from a group of style plans. The house itself was not that spectacular, but it had the equivalent of a health club grafted to one side complete with basketball court. The other houses were acquired to house his domestic staff and bodyguards. One of the houses was for Stoecker's personal pilot. Stoecker had acquired three jets, a helicopter, and a stretch Mercedes Benz limousine to make it easier to visit his operating companies and his other multi-million dollar home on the Gulf Front in Naples, Florida.\textsuperscript{17} Finally, he had a home in Lake Forest which would go on the market at $1.5 million during bankruptcy proceedings.\textsuperscript{18}

Stoecker was very careful about security too. He took out a kidnapping insurance policy on himself and hired armed bodyguards. His home was under 24 hour surveillance. At the Grabill office complex it took two codes to reach the top

\textsuperscript{15} Ibid.


\textsuperscript{17} Silberman, "The Fall of the House of Stoecker," p. 178.

\textsuperscript{18} Okon, "Stoecker legal fees queried," p. 3.
executive offices on the third floor. Surveillance cameras watched visitors from hidden niches and visitor's passes even changed color if worn outside. In fact, even most of the people working on the second floor of the complex couldn't get into the executive offices unescorted.19

While Stoecker's company was growing, Stoecker himself was becoming Oak Forest's favorite businessman. Grabill Corporation became the town's largest employer. Overall, Stoecker's organizations employed 5,500 people and reported revenues of $750 million for fiscal year 1988. Oak Forest had never seen Christmas decorations on Cicero avenue until Stoecker donated the money for them. He also donated $58,000 to his high school so that they could purchase lights for the football field.

Even Moraine Valley Community College of Palos Hills where Stoecker spent one semester was given $4 million dollars to help build a performing arts center. The donation, which was believed to be the second largest endowment ever given to a community college, was intended to build a 1,200 seat theater and an art gallery. For Moraine Valley, the donation was 20 times larger than what the school's entire foundation would normally receive even in its best years.20 (Stoecker, however only ended up making good on about $2 million of the gift).21

Still another donation was planned for the Illinois Institute of Technology (IIT) for $10 million. The money was supposed to help build a high-tech campus in the heart of the Illinois research and development corridor in Du Page County. Originally both the University of Illinois and Northern Illinois University had wanted to be the leader among a group of colleges which would collectively set up a separate "multi-university" in this area. However, after a number of years without receiving funds, IIT took the initiative to start the project based on the fact that they could move faster because they were a private university.\(^22\)

So it seemed to most people that Stoecker really knew what he was doing. He was a phenomenal success story. By the time Stoecker was 30, his accountants figured he had enough money to make him one of the 200 richest people in America.\(^23\) But what made Bill Stoecker, a community college dropout, such a phenomenal success? Neither Stoecker nor the rest of his executive staff was experienced in mergers and acquisitions. Stoecker referred to his executives as "the mutants" because they were thrown into positions they were not trained for and had to adapt quickly. Stoecker intended to bring people along, "making it up as they went." Many people outside of the company felt, however, that many of these executives were in over their heads. The chief executive officer, Philip Ignarski, had worked in a


\(^{23}\) Gelber, "Whiz Kid," p. 3.
local law practice where he specialized in "real estate, business, and divorce." The vice president of planning, Lawrence Pluhar, was also the helicopter pilot. The chief financial officer, Richard Bock, had some experience in accounting, and arranging the manufacture and distribution of a product called "Mrs. Durkin's Old Fashion Lickers."  

Problems Begin for Stoecker.

The first rift in the story came after the release of the October 31, 1988 edition of Forbes magazine. The article in Forbes was entitled "Love Those Gullible Bankers," and it came in response to an article published in the Chicago Tribune a year earlier which was called "The Oak Forest Whiz Whom Forbes Missed." The Tribune reported that Stoecker's net worth exceeded $250 million and that therefore Stoecker belonged on the Forbes Four Hundred list. Forbes looked into Stoecker's situation and reported that "with Bill Stoecker there is less than meets the eye. Far from being a centimillionaire, Bill Stoecker may have several million or even no millions at all...It depends on whose figures you believe."  

The Forbes article brought a number of facts to the world's attention, specifically dealing with two of his operating companies: Capitol Technologies (South Bend, Indiana) and Detroit Armor. Apparently Stoecker had paid $5 million cash to acquire Capitol Technologies in 1984. Stoecker claimed that the


$5 million was raised through profits in his rehab work. The article stated, however, that "evidence available to Forbes suggests he didn't make anything like that in real estate. He was a small-scale operator, and only for a brief period."  

Forbes reported that within a year, Capitol's debt had risen from $400,000 to $5.5 million and that the retained earnings of over $2 million had shrunk to under $350,000. Stoecker would later admit to Forbes that he put virtually no equity into the deal and that he had essentially bought Capitol with its own assets. Stoecker had given a different story to General Motors. GM, one of Capitol's biggest customers, was informed by Stoecker that Grabill had virtually no debt and that there was "little leverage" in the purchase of Capitol.

Stoecker also handed a similar story to AmeriTrust banking company. After assuring AmeriTrust that Grabill had virtually no debt and that operations were going well, AmeriTrust agreed to lend Grabill Corp. $15 million. Forbes reported that they were able to learn of internal records which reported that Grabill's debt level was already $15 million by 1985, not to mention the decreases of Grabill's retained earnings of $2.5 million in '85 and $3.7 million in 1986. Additionally, Stoecker had promised audited financials to AmeriTrust which he never produced even a year later. Further reported in the Forbes article was that

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26 Ibid. p. 79.
27 Ibid.
Stoecker had asked Salomon Brothers (an investment banking firm) for a $150 million loan through a loan syndication.\textsuperscript{28}

The financials that were given to Salomon claimed that Grabill would be worth $219 million on the open market. But Salomon wanted more solid information. The information was not forthcoming and negotiations stalled. The table below shows some of the information which was given to Salomon Brothers compared to information that people with firsthand knowledge of Grabill's books provided to Forbes:

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<th>FIGURES GIVEN TO SALOMON</th>
<th>FIGURES ACQUIRED BY FORBES</th>
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<tr>
<td>Detroit Armor</td>
<td>Sales $10.7mill</td>
<td>Gain/(loss) $960,000</td>
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<td>(Fiscal 1987)</td>
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<tr>
<td>Capitol Tech.</td>
<td>Sales $22.78mill</td>
<td>Gain/(loss) $4.16mill</td>
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<td>(Fiscal 1986)</td>
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Forbes reported that not only were the numbers which Stoecker gave to Salomon wrong, but also that Laventhol & Horwath used those same figures to prepare a personal balance sheet for Stoecker. The article stated, "This mixture of audited and unaudited numbers showed a net worth for Stoecker in mid-1987 of $332 million. Even though Salomon would not vouch for the figures, Laventhol accepted them as the basis for its estimates."\textsuperscript{29}

\textsuperscript{28} Ibid. pp. 79,83.

\textsuperscript{29} Ibid. p. 83.
The publication of the Forbes article worried a lot of banks especially the Bank of New England consortium (which had opened a Chicago lending office to make loans in the Rust Belt) that loaned Grabill $150 million. The article shocked and embarrassed the Bank of New England because it noted that the bank had loaned Grabill the $150 million requiring no collateral because of Grabill's apparent financial strength. How did the Bank of New England determine that Grabill was financially sound? It was based on financial statements which Laventhol & Horwath had prepared!³⁰ Finally, Grabill would be forced into bankruptcy (initiated by eight banks led by the Bank of New England) after missing a principal payment of $2.5 million. (A larger interest payment of $3.8 million which was due at the same time was made on time.)³¹ The Bank of New England had promised to lend Grabill more money (which would have enabled Grabill to meet its payment), but backed out on their promise after the publication of the article in Forbes magazine. So, after an attempt by The Bank of New England and its consortium to force Grabill into Chapter 7 bankruptcy, Grabill filed for Chapter 11 bankruptcy on February 3, 1989 (and was eventually placed under Chapter 11).³²

³⁰Ibid.

³¹Elsner and Sly, "Grabill case: Matter of fraud or ineptitude?," p. 3.

Grabill/Stoecker Bankruptcy Proceedings.

The bankruptcy did not go very smoothly. Early in the proceedings a judge required that new attorneys be appointed for Grabill. There was a conflict of interest situation because Grabill's original attorneys had also represented Stoecker personally, and Stoecker had subsequently resigned from Grabill. There were also a number of allegations made by the banks which had loaned Grabill or Stoecker money. One allegation was that Stoecker had used Grabill funds for his personal benefit. On February 2, 1989, an interim trustee was appointed to investigate bank charges against Grabill and to trace a reported $100 million that the banks accused Stoecker of siphoning from Grabill. Coopers & Lybrand was hired to help track down the $100 million; and it proved to be a time consuming process. Harris Bank & Trust attorney Nathan Elmer voiced his opinion about the difficulty of tracing the $100 million. He referred to it as "a simple question...Mr. Stoecker should be able to tell us in 10 minutes or less."

In yet other charges, The Bank of New England charged Stoecker with forging a letter which purported to give Stoecker a "free hand" in the use of their loan. The letter was allegedly written by Donna Pellegrini, The Bank of New England's vice president. The letter exempted his real estate assets from the

33 "Judge orders new Grabill attorneys," p. 3.
terms of a loan. If it was found to be genuine, Stoecker was entitled to dispose of real estate assets.\(^{36}\) It was later determined by a document expert to be genuine. Another expert noted that the letter in question was a facsimile and contained a coding on the bottom of the facsimile reproduction which was produced by the receiving facsimile machine. This "receiving" code proved that the original letter was transmitted from the machine at the Chicago office of the Bank of New England.\(^{37}\)

There were also a number of criminal charges for bankruptcy fraud for not disclosing assets. Charges were made that Stoecker didn't report $900,000 in assets to the bankruptcy trustee. Part of this money was found in an April 15th FBI raid on Stoecker's home. Among the assets found by the FBI in a safe at Stoecker's home were:

- $300,000 in negotiable checks including 5 that were transferred into a maid's bank account.

- A $500,000 promissory note.

- Written appraisals of jewelry totaling $100,000.

- $12,000 in cash and $3,000 in travelers checks.

Some of the $300,000 in checks were apparently transferred to the maid's bank account on the advice of a lawyer to pay household expenses. It was determined that the promissory note had already been used and that the jewelry belonged to his wife who had divorced him. He was eventually indicted on May 16th for hiding

\(^{36}\) Sly, "Accountants can't find chunk of Grabill assets," p. 4.

$255,000 in assets from the bankruptcy trustee overseeing his estate.\textsuperscript{38}

Other charges were made that Stoecker withdrew $30 million from company accounts and shredded financial (loan) documents.\textsuperscript{39}
There was eventually concern about where Stoecker was getting money to pay his legal fees. Thomas Durkin, Stoecker's lawyer, would not disclose the names of the people paying for Stoecker's legal fees because the third parties did not want to be identified. In criminal proceedings, parties often pay legal fees and remain undisclosed. However, since this was a bankruptcy case, the lawyer was forced to disclose this information to ensure that the legal fees were not coming from money that Stoecker had transferred to third parties.\textsuperscript{40}

The bankruptcy trustees themselves were not without blame for the problems occurring during the bankruptcy. Trustee Thomas Raleigh at one point had rerouted Stoecker's mail to his own office. Stoecker's attorney, Thomas Durkin, argued that this constituted an illegal search and seizure without a warrant. Raleigh took this action to help insure that information was not being withheld from him. He noted to bankruptcy Judge John Squires that he had learned of a $1.5 million certificate of deposit at Hayes National Bank in Clinton, New York, only because a $10,500 payment had been addressed to Stoecker at the Grabill

\begin{itemize}
\item \textsuperscript{38} Okon, "Stoecker indicted," pp. A1, A4.
\item \textsuperscript{39} Reed, "Bankruptcy rocks Stoecker's empire," p. 67.
\item \textsuperscript{40} Okon, "Stoecker legal fees queried," p. 1.
\end{itemize}
headquarters. Raleigh rerouted Stoecker's personal mail because he thought information about other undisclosed assets might be revealed through mail correspondence at Stoecker's personal address. However, Raleigh did not open the mail he received because he learned his actions would be contested. In June '89, Judge Squires ordered the mail (which had not been opened since May 3rd) to be turned over to Stoecker's attorney.

There were also complications during the seizure of corporate assets which were to be auctioned to liquidate Grabill Corp. The seizure of the Grabill art collection and other assets (including one of the airplanes which had been tagged by a deputy at Midway Airport in Chicago) was halted. The seizure was stopped due to disputes concerning whether the assets were part of Grabill Corp. or part of Stoecker's personal assets. With all the confusion and lack of documentation in the records, it was very difficult in the proceedings to determine who actually owned the assets even after they were found. In the final bankruptcy settlement made with the eight bank consortium that forced Grabill into bankruptcy, a special arrangement was made. Rather than sharing in distributions in a pro-rata fashion, an agreement was made to allow smaller banks with loans under $50,000 to be paid in full before distributing the remainder to the larger banks.

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41 Okon, "Trustee wants access to Stoecker's mail," p. 1.
42 Okon, "Stoecker legal fees queried," p. 3.
So William Stoecker fooled the world. In a memo that circulated in one of the banks that loaned Stoecker money, it was reported that he was somewhat "unsophisticated" about how banks operated. With hindsight one might argue that he knew exactly what he was doing. He knew how to charm a banker. His charm alone made him into a "success" for a while. A comment by an officer from a regional bank which had loaned Stoecker money without audited financials, reported that he felt "the magnitude was so great, if even half of it was true you thought you had something. It's clear now I didn't do my homework, but neither did a lot of other bankers."44

CHAPTER 3

LAVENTHOL & HORWATH: A TROUBLED PARTNERSHIP

While the Grabill episode eventually resulted in the dismantling of Laventhol & Horwath, it was by no means the only event which seemed to result in a questioning of the integrity and reliability of this firm's work. Grabill Corporation wasn't the beginning of their problems; it was just the nail in the coffin.

After two decades of tremendous growth, Laventhol was besieged by a myriad of problems that quickly led to its demise. What happened? Was the quality in their work really lost? The following sections attempt to look back at the dynamic growth of Laventhol & Horwath over the past two decades, the numerous difficulties that befell the firm in the late 1980's, and the eventual collapse of the firm under the pressure of the Grabill case.

Too Much Too Fast? - Was Quality Jeopardized?

Some would suggest that the start of Laventhol & Horwath's problems really began with their overwhelming drive for bigness starting back in the late 1960's. Many years ago, Laventhol & Horwath was not the big accounting firm that it had become in the few years before its bankruptcy. Laventhol experienced tremendous growth. Much of this growth came through mergers. Between 1968 and 1980 they had acquired no less than 70 other firms. In one single year, Laventhol had acquired 13 additional
firms. Along with the acquisitions, '80-'86 revenue grew fourfold while revenue in the period from '86 to '90 grew 28% more.\textsuperscript{45} Even with fierce competition in the industry for audit clients, Laventhol's U.S. revenue grew in the last 10 years from $70.8 million to an estimated $350 million in 1990.\textsuperscript{46}

Despite the firms growth, they began to have a number of highly publicized legal claims, of which the most publicized and worst (so far) has been the Grabill/Stoecker case. The Grabill case was called by one partner "the darkest day in the firm's history." All of the people who worked on the Grabill audits were eventually released or had resigned.\textsuperscript{47} Lawsuits have charged that the firm had ignored professional principles to achieve growth. In the past three years Laventhol has paid out over $50 million in claims resulting from sloppy audit work.\textsuperscript{48} Additionally, Laventhol revealed during their filing for Chapter 11 protection that the firm had at least 100 lawsuits pending seeking over $2 billion in damages.\textsuperscript{49}

The Chicago office of Laventhol & Horwath was one of the largest of the Laventhol offices. Overall, Laventhol had about


\textsuperscript{46} Cohen and Goozner, "Laventhol woes add to debate on accounting," p. 6.

\textsuperscript{47} Ibid.

\textsuperscript{48} Cohen, "Charting quality course, Laventhol says," p. 3.

\textsuperscript{49} Pae, "Laventhol Bankruptcy Filing Indicates Liabilities May Be As Much As $2 Billion," p. A-4.
425 partners in 51 offices.\textsuperscript{50} The Chicago office had 35 partners with over 400 employees.\textsuperscript{51} Many of the lawsuits that Laventhol faced resulted from audits performed by the Chicago office. Kenneth Solomon was the managing partner of the Chicago office and was highly regarded at one time for building the Chicago office to be the 6th largest accounting operation in the city, from being number 16 only twelve years earlier. He helped to make Laventhol into the city's biggest firm that specialized in mid-sized, privately held companies with annual revenues in the area of $2 to $150 million.\textsuperscript{52} When Laventhol began to experience problems however, Solomon began to lose his popularity. Some people blamed Solomon for being too aggressive in trying to cut costs by cutting staff numbers. Among other shortcomings, Solomon actively solicited Stoecker's business.

Amid Laventhol's legal problems, the newspapers began to focus on the downside to Laventhol's growth. In 1989 operating profits before litigation costs dropped by 9\% and average earnings for the partners (after legal payouts) declined 35\%.\textsuperscript{53} Then, in 1990, the firm decided not to issue financial statements for the first time in 10 years. Unlike a corporation, businesses


\textsuperscript{51} Elsner and Cohen, "Top accounting firm may seek protection." p. 3.

\textsuperscript{52} Cohen and Goozner, "Laventhol woes add to debate on accounting," p. 6.

\textsuperscript{53} Cohen, "Charting quality course, Laventhol says," p. 3.
set up as partnerships (like accounting firms) are not required to publish financial statements for the public. However, Laventhol had previously prepared financial statements to highlight the tremendous growth it was having. When asked why they were not releasing financial statements, a spokesman replied, "Why bother?" and refused to admit the reason was related to Laventhol's problems.\footnote{Ibid.}

A Mountain of Lawsuits...Not Just Grabill.

Following its years of tremendous growth, the 1980's brought Laventhol a myriad of legal problems which seem to question the quality of the work being performed by this firm. In fact, by the time of its eventual filing for bankruptcy in 1990, Laventhol & Horwath had more than 100 lawsuits outstanding for claims in excess of $2 billion dollars. Grabill was by no means the first warning to Laventhol that it needed to look at the quality of their work...it was simply their last. Was it to Laventhol & Horwath management that something needed to be done and, if so, was it simply too late or did their management knowingly choose to ignore the firms growing problems?

Looking at the different claims Laventhol was facing indicates that at least some of them may have been preventable. In the summer of 1982, a senior staff member sent his boss a memo questioning deductions Laventhol was taking while preparing tax returns for several limited partnerships. In the memo which was
written to the New York managing partner Leonard Douglas (by Lawrence Reisman and his boss, Martin Helpbern), issues were raised such as if Laventhol's "reputation as a 'professional firm' [would be] enhanced by our association with this type of 'sham?'" and if "the loss of reputation...[would be] compensated by the present $ [money] generated?" The response to the memo given by Douglas concerning the invalid deductions was that, "Every person is entitled to be represented by as competent a professional as he can get....Even in criminal law, there is a guaranteed right under the constitution. The client is entitled to representation." Laventhol & Horwath continued to work for the limited partnership for the next 3 years. Eventually, the IRS disallowed the deductions claimed by Terra Drill & Oil's investors. In December of 1989, a federal jury made a $72 million dollar judgment against Laventhol for violating antifraud statutes in working for the shelter. Laventhol eventually settled for $13.5 million of which only $4.4 million was covered by insurance. Laventhol had offered to settle before the trial for $5 million. Douglas later resigned. Reisman, (who wrote the memo), left Laventhol in 1983. He set up a tax practice in New York. He claimed to be "upset" about Laventhol's professional standards. "The urge to take such risks there was too ferocious...The dog-eat-dog atmosphere and knowledge that if you


weren't willing to cut a corner, someone else would be found there who will, was too much for me."  

Again in 1988, Laventhol made an out-of-court settlement for $15 million in a suit it lost under the Racketeer Influenced and Corrupt Organizations (RICO) law. (This made Laventhol the first accounting firm to lose a case under RICO.) The jury ruled that investors relying on financial statements audited by Laventhol invested $20 million into fraudulent cattle-breeding tax shelters which later collapsed. The collapse resulted in the investors also being hit with tax penalties. Laventhol reported that insurance covered this loss.  

Although Grabill Corporation created one of Laventhol's biggest suits, another lawsuit which stemmed from a Chicago office client is that of Convenient Food Mart. Laventhol was charged with not adequately reviewing and checking working papers which were prepared by Convenient. It was later revealed by Convenient that they had overstated 1987 profits by 68%. Yet another Chicago office related lawsuit is that of Wieboldt Stores Inc. Laventhol issued a report which stated that a leveraged buy-out of the company would not make it insolvent. Stockholder-managers were later sued for running the company into the ground.

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58 Ibid.
59 Ibid.
and they charged, in the same court, that Laventhol had misrepresented Wieboldt's finances. 60

Laventhol also faced litigation in connection with work done for Evangelist Jim Bakker's PTL ministries. A number of investors with "lifetime memberships" charged that a fraud had been perpetrated against them. The suit alleged that Laventhol helped Bakker "cook the books" by turning what was a $19 million loss into a $26 million profit on paper. This was done through a change in the method of amortizing lifetime partner income. (Laventhol would argue that it did qualify its 1986 audit opinion based in part from reservations about PTL's finances.) Laventhol was charging $180,000 a year in audit fees. The suit charged that $60,000 of this amount was given to Laventhol to maintain a "secret bank account" that was used to conceal allegedly embezzled funds by top officers. Laventhol took the PTL as a client in 1984 after Deloitte, Haskins & Sells dropped the client for "unexplained reasons." This, however, did not stop Laventhol in its thirst for growth. Although they received $180,000 a year in audit fees, Laventhol eventually wound up with a lawsuit seeking $184 million. 61

Legal Problems Lead to Partner Defections and Cash Shortages.

Beset by this myriad of legal problems, the downward spiral of Laventhol was accelerated by the battle for leadership within

60 Cohen and Goozner, "Laventhol woes add to debate on accounting," p. 6.

the firm, the abrupt defection of many partners, and the inability of the firm to raise sufficient cash to keep its operations going.

While Laventhol was proceeding through its difficulties, the once hailed Kenneth Solomon was competing for the position of chief executive officer of Laventhol & Horwath, a job which he had long coveted; however, in 1989 he was passed over for this job and the position was filled by Robert Levine who was a managing partner from San Francisco. Also, during 1989, Solomon was voted out of the position of chairman which he had held for the 10 years prior to 1989. Solomon's problems seemed to grow as Laventhol's did, which seems to corroborate the blame which many partners placed on Solomon for Laventhol's legal problems resulting from audits done by the Chicago office.\(^{62}\) It was not long before Solomon resigned as head of the Chicago office and was replaced by Sheldon Epstein. Epstein pledged tighter quality controls, but Laventhol was already beyond help.

Laventhol's problems began to compound from the beginning. Besides losing Solomon, Laventhol was experiencing many partner defections because of the problems that the firm was experiencing. From the beginning of 1989 until mid-1990 partner numbers declined about 17%.\(^{63}\) Bruce Richman, a health-care

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\(^{63}\) Cohen, "Charting quality course, Laventhol says," p. 3.
consultant at Laventhol, when asked why he was leaving replied, "It's no secret about what's going on at Laventhol."

More trouble for Laventhol came when they lost their Toronto office which consisted of about 30 partners and 200 professional staff. The office was one of four Canadian offices of Laventhol and Horwath, the other three being in Vancouver, Winnipeg, and Montreal. Revenue from the Toronto office amounted to about $25 million Canadian dollars ($21.3 million U.S. dollars). The Toronto office was a very important office in making Laventhol an international firm. The office defected to Price Waterhouse. Eric Slavens, co-managing partner of the Toronto office, indicated their reasons for defecting as being "because we need more cross-country coverage for clients in Canada." In light of Laventhol's circumstances, however, other motives would appear to have been present.

At the same time that Laventhol was facing so many difficult lawsuits, partner defections, and other related problems, the firm also began to experience serious cash flow problems. In an attempt to mitigate these problems, in October of 1990 Laventhol put into effect a 10% pay cut across the country for its 3,300 employees. It was stated that the pay cut was implemented to mitigate further layoffs. Additionally, the firm cut its October 1990 pension benefits to its partners. A spokesman for Laventhol

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65 Ibid.
in Philadelphia stated "we have paid this month and will pay next month...but we don't divulge how much we pay." One retired partner, however, indicated that his pension benefit check was cut by about 80%. Although the firm indicated that all pension benefits would be paid by May 15th (the end of the pension year), The cash squeeze, combined with the fact that Laventhol had an unfunded pension plan which was paid out of current earnings, resulted in the reduction of the current benefits being paid. Originally, CEO Robert Levine had recommended that the pension benefits be suspended completely until after January 31st; however, this recommendation was settled through the 80% reduction compromise. The future would show that Laventhol would not even last until January 31st.66

Still experiencing cash flow problems, partners met in Houston and rejected a proposal to pump $15 million in funds into Laventhol (which would have amounted to about $50,000 for each of its 320 partners). None of Laventhol's main lenders, which included Chase Manhattan Bank and Fidelity Bank of Philadelphia, were willing to give additional loans.67 Chase Manhattan Bank had already placed 3 employees at Laventhol's Philadelphia office to monitor receivables for their $80 million loan package (double

66 Cohen, "Laventhol retirees find pension check cut 80%," p. 2.

67 Elsner and Cohen, "Top accounting firm may seek protection," p. 3.
what Laventhol had borrowed prior to 1990).68 The bank had suggested earlier in 1990 that Laventhol sell off two of its divisions, Construction Monitoring and Valuation Counselors, in order "to put the accounting firm on a sounder financial footing." Construction Monitoring was based in New York. It "value[d] construction projects for financial institutions and monitor[ed] conformance with construction-loan agreements." Its revenue amounted to about $3 to $4 million per year. Valuation Counselors valued "businesses, assets, property and equipment and [had performed] real-estate and health-care facility appraisals." Valuation Counselors was based in Chicago and had annual revenues of over $19 million.69

The Nail in the Coffin: Grabill.
While some of the earlier lawsuits might have indicated that something had been lost in the quality of Laventhol's work, the Grabill case clearly brought this issue to the attention of the public, the accounting industry, and the courts, once again.

What was so wrong with their work on the Grabill Corporation? Even inexperienced auditors would seem to understand the need to look at documentary evidence supporting the existence of assets and liabilities before attesting to a set of financial statements to at least making sure that the


69 Ibid.
companies being reported on existed. Did Laventhol follow even these rudimentary guidelines in the Grabill case?

The trustee appointed to handle the affairs of the now bankrupt Grabill corporation along with the accounting firm of KPMG Peat Marwick were able to find only $128 million of the $390 million in assets which were reported in the '88 financial statements.\textsuperscript{70} Included as assets were a number of shell companies with little or no value, but which appeared in the financial statements at up to $60 million each.\textsuperscript{71} There were three companies with assets totaling $30 million and sales totaling $5.3 million for which no records were found at all.\textsuperscript{72} Also lacking supporting records was all but $521,000 of real estate which was listed in the Grabill statements at $74 million.\textsuperscript{73} There was confusion about whether the records actually did not exist, or if they merely could not be found. Even records indicating the existence of the corporate headquarters itself could not be found at the corporate offices. None of the missing records were ever reported as being found.

Probably even more highly publicized than the Grabill financial statements were Stoecker's personal financial statements which were also prepared by Laventhol & Horwath.

\textsuperscript{70} Sly, "Accountants can't find chunk of Grabill assets," p. 1.

\textsuperscript{71} Silberman, "The Fall of the House of Stoecker," p. 208.

\textsuperscript{72} Okon, "Grabill assets escape detection," p. 3.

\textsuperscript{73} Okon, "Grabill mystery far from over," p. 4.
Stoecker's personal financial statements were equally interesting. They claimed that he had $74 million in real-estate, and cash and stocks amounting to $220 million. The financials reported Stoecker's personal fortune in excess of $500 million. The personal trustee which was appointed to handle Stoecker's affairs determined, however, that he was $50 million in the hole and that he owed $153 million to 32 lenders. No documentary evidence was found for the existence of 22 firms that were reported as Stoecker's personal assets. These firms were listed as being worth $551 million and having assets of $817 million. Then there was Chandler Enterprises which was valued at $63 million. Stoecker offered Chandler's assets as collateral for a loan. He said that Chandler was a "diverse manufacture and machining house." The company, however, did not exist. Chandler was one of five Stoecker-owned companies that were reported by Laventhol & Horwath as being collectively worth $232 million. In a "60 Minutes" episode on January 14, 1990 during which Bill Stoecker was interviewed, it was reported that "their actual value was close to zero." Another company, Kimberton Corp., was listed as one of Stoecker's personal assets and his financial statements indicated he had a $26 million dollar interest in the company. However, the only asset that the company had was a $10

74 Gelber, "Whiz Kid," p. 4.

75 Sly, "Ex-Grabill chief's assets come up 22 firms short," p. 5.

76 Gelber, "Whiz Kid," p. 5.
million dollar leased aircraft. It is instances such as these which point to possible fraud in the preparation of the financial statements, instead of merely inadequate work.

Court-appointed bankruptcy trustees were saying from the beginning that "Laventhol & Horwath's financial statements were riddled with falsehoods." So the question arises about whether the auditors had done a reasonable investigation or if they were negligent in their audit work. There are surrounding facts that would point to the answer as being negligence or perhaps even fraud. The fact that the financials contained such large, obvious misstatements would seem to indicate negligence by Laventhol. Additionally, it was reported that Laventhol was receiving audit fees of $158,000 per month and that they received over $2 million in fees during 1988. The level of audit fees in this case has been reported as "unheard of." The excessive fees also raise questions of possible fraud in association with Laventhol's work. In their defense, 60 minutes reported that Laventhol may plead that they were dealing with "a cunning criminal" and that they could not have been equipped to deal with the sorts of situations they encountered. But the fact that there were nonexistent companies in question raises serious doubts about the adequacy of their audit work and thus the

77 O'Dea, "Why Laventhol's perils won't fade," p. 27.
78 Gelber, "Whiz Kid," p. 4.
79 Elsner and Sly, "Grabill case: Matter of fraud or ineptitude?" p. 3.
validity of this defense. "You find a nonexistent company by going out and kicking the tires. Did they go out and kick the tires? Did they actually physically go out and try and look at one of those nonexistent companies?" The answer fairly clearly seems to be "no," and thus there is little that would indicate that there was anything short of gross negligence or fraud in this case.

Laventhol faced certain litigation for its involvement with Grabill Corporation and also for the personal financial information they audited for William Stoecker. Laventhol agreed to pay Grabill Corporation's creditors $30 million in an out-of-court settlement (of which only $20 million was covered by Laventhol's insurance). As of December 1990, Laventhol had made no settlement on a lawsuit concerning Stoecker's personal financial statements. The sale of Stoecker's personal assets during the bankruptcy proceedings amounted to only $35 million despite the fact that the Laventhol & Horwath statements suggested that Stoecker's personal net worth was over $500 million. Additionally, the trustee in charge of Stoecker's estate, Thomas Raleigh, is still trying to recover another $30 million in two lawsuits. One of these lawsuits involves an alleged fraudulent transfer of $25 million to First Union Bank of North Carolina, which Stoecker tried to repay just before bankruptcy.  

The other $5 million which Raleigh is attempting to recover is in a suit against Stoecker's former wife Grace. At the time they were divorced (summer 1988), Stoecker said he lost Grace "in the struggle to figure out how rich people live. He cluttered their lives with butlers, nannies, chefs, pilots, housekeepers, chauffeurs, and the ever-present bodyguards (all of whom socialized and shared meals with the young couple...)." Their divorce might also have related to complaints from Stoecker's secretaries to the EEOC who claimed that Stoecker had made advances towards them and then fired them when they shunned him. At the time the divorce took place, the $5 million divorce settlement made it look like Grace either knew the financial statements were wrong, or she was cutting herself a bad deal. Considering Stoecker's actual negative net worth, the $5 million would have been a real good settlement; and the trustee wants it back. 

The End: Bankruptcy.
Unable to acquire needed cash through either bank loans or partner contributions, Laventhol & Horwath filed for bankruptcy in November of 1990. Prior to the filing, sources were reporting Laventhol's net worth to be negative (down from $60 million the year before). Upon filing, however, it was determined that "the accounting firm and its partners face vastly larger

82 Silberman, "The Fall of the House of Stoecker," p. 179.
potential liabilities than had previously been indicated." The firm was facing about 100 lawsuits at the time of the bankruptcy which were seeking more than $2 billion in settlements. A Wall Street Journal article reported that "Laventhal has been beset by costly litigation claims and softness in business, particularly in consulting services."\(^{85}\) Previously, papers had reported that consulting services was a tremendous growth area, but that most litigation had resulted from sloppy audits.

"In the filing, Laventhal listed assets of $146.4 million including $81 million in net receivables, and property and equipment of $50.5 million. The liabilities include $76.8 million in bank debts, principally Chase Manhattan Bank and Fidelity Bank of Philadelphia, and $37.8 million listed as a long-term portion of litigation settlements payable. The balance sheet showed a partners' deficit of $6.9 million."\(^{86}\)

\(^{85}\) Pae, "Laventhal Bankruptcy Filing Indicates Liabilities May Be As Much As $2 Billion," p. A-4.

\(^{86}\) Ibid.
CHAPTER 4
TODAY'S ACCOUNTING INDUSTRY

While it would perhaps be easy to close summarizing the downfall of Laventhol as due to its own shortcomings in terms of the quality of its work, it must be noted that Laventhol is not alone in the problems it has faced. Perhaps they are the first large public accounting firm to declare bankruptcy, but others seem to be experiencing similar legal problems and, in fact, the accounting industry as a whole seems to be facing some difficult times.

Other Firms Encountering Difficult Times.
It seems that a number of accounting firms are currently facing hard times. Ernst & Young has been heavily involved in the S&L industry and they began to run advertisements in newspapers such as The Wall Street Journal and The New York Times declaring that the company is "in very strong financial condition." The press was also running other articles, indicating that this move was apparently made to dispel rumors that Ernst & Young might also be considering bankruptcy. They deny that they have considered such a step, despite the fact that they are being sued by the Federal Deposit Insurance Corporation for $560 million in connection with Arthur Young work for a Western Savings Association in Dallas. Ernst & Young also faces litigation in connection with their predecessor's audits of Lincoln Savings & Loan Association, "the largest thrift failure
in the U.S.," as well as Vernon Savings & Loan Association in Dallas. In fact, it is because of Arthur Young's audits in connection with the Lincoln Savings and Loan Association that the State of California's licensing board is trying to revoke Ernst & Young's license to practice accounting in that state.

Coopers & Lybrand are also currently facing problems related to work in the S&L industry. Coopers paid a penalty to federal thrift regulators that charged the firm with "materially understating potential losses" in connection with a 1986 audit of Silverado Banking, Savings & Loan Association. Coopers neither admitted or denied the charges, but rather paid the penalty in order to avoid the expense and publicity that would arise with a trial. The case marked the first action taken against a Big Six accounting firm by the Office of Thrift Supervision. The thrift office charged that the 1986 audited financial statements reported capital "improperly inflated by $14 million," and that the "allowance for loan losses of $23 million should have been roughly $35 million higher."

Another manifestation of the present problems firms are having is the case of Spicer & Oppenheim. Spicer & Oppenheim decided to disband because of the "weakening economy and the continual defection of partners and staff." Stephen Oppenheim, the son of the founder and who was the firm's chairman, expressed

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87 Pae, "Ernst & Young, In Full-Page Ads, Seeks To End Rumors It May Seek Chapter 11," p. A-5.

his belief that other firms will experience similar problems because of the present condition of the industry. Although Spicer had relatively few litigation claims, the firm had cash flow problems due in part to slowing growth in the industry. Spicer & Oppenheimer also "overextended" itself by entering into an expensive lease for office space in Manhattan. Finally, Spicer & Oppenheimer claimed that since many of its clients were securities firms, when the stock market crashed in 1990, this too hurt their business.89

The list of major accounting firms facing litigation and cash shortages could continue to go on. The above-mentioned cases are just a sample of the problems that some of the major accounting firms are facing today. Times are clearly difficult for accounting firms right now. In addition to the firms mentioned above, even Peat Marwick and Deloitte & Touche began laying off administrative employees in December of 1990 to streamline their operations and help to reduce the effect of the present economy.90

Changing Attitudes Towards Risk.

Lawsuits against accountants are changing accountants' attitudes toward risk and the increasing number of lawsuits are having a dramatic effect on the industry. A survey conducted by Johnson & Higgins, a New York insurance broker, stated that four


out of five certified public accountants have cut back on the services they provide. Of the 500 accountants polled, 56 percent have stopped doing business with what they considered to be "high risk" clients. Also, 98 percent of those polled now ask clients to sign some type of protective contract before they begin work. Although S&Ls top the list of businesses accountants are avoiding, accountants are also wary of start-up companies and companies making initial public offerings.\(^9\)

The present situation of the accounting industry is really taking its toll on insurance costs. One partner of a mid-sized accounting firm noted that in the mid-80's he was paying about $30,000 a year for $7 million in coverage. Today he pays $200,000 for only $5 million.\(^2\)

**Accountant Liability & the "Deep Pockets" Theory.**

The increased litigation against accountants has been referred to as the "deep pockets" theory by many in the field. The name refers to the fact that it is often the accountants (among others) which shareholders and other plaintiffs sue when a business fails because it is the accounting firms that have the money while obviously the failed businesses do not. Lawrence Weinbach, chief executive of Arthur Andersen & Co.'s worldwide organization has said, "The 'deep pockets' theory [under which the parties with the most assets may wind up paying all legal

\(^9\) Caprino, "Fear of lawsuits has CPA firms turning away marginal business," p. 3.

\(^2\) Ibid.
damages] is absolutely incorrect." He and others feel that auditors and other parties should be liable in relation to the extent that their roles played in the failure. Under this theory, it has also been suggested that an accounting firm's best defense is not having insurance against litigation. "They don't want your house, they want money," is what one accountant said about those who are suing accounting firms.

Perhaps the worst part of the accounting profession's situation lies in the fact that most state statutes require accounting organizations to be run as partnerships rather than corporations. Under partnership law, partners are personally liable for any deficit resulting from a lawsuit. What is so ironic is that accountants have set their own standard of liability in their codes which denote their level of responsibility. The state laws on liability, in turn, mirror the accountants' own codes. Additionally, new Statements on Accounting Standards have been issued in an attempt to reconcile some of the dispute over what the auditor's responsibilities are. Dubbed the "expectation gap" standards, these standards are resulting in the auditor taking increasingly higher levels of responsibility for the work they perform. "Members of the institute soon will be asked to vote on amending the group's code of professional conduct to allow public accounting firms to

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93 Cohen, "Party's over as CPAs face tough times," p. 4.
function as limited-liability corporations. But a favorable vote will only serve as ammunition to be hurled at lawmakers."95

95 Caprino, "Notion of liability for partners built into accountants' own code," p. 6.
CHAPTER 5

CONCLUSIONS

If one could go back in time, they would not have to go back very far to enter a time in which the bankruptcy of an accounting firm like Laventhal & Horwath would have seemed impossible. However, amidst the changes taking place in the accounting industry today and the increasing competition in the industry, there has been a plethora of lawsuits that seek to find accountants liable for business failures. Bankruptcy of an accounting firm is a reality. Laventhal & Horwath filed for Chapter 11; Spicer & Oppenheim decided to dissolve rather than seek Chapter 11 bankruptcy protection; and other firms have become increasingly concerned with the trend of lawsuits against auditing firms. For some firms, it may be a matter of the "deep pockets" theory; if a business fails, blame the accountant. But for Laventhal, the problem went much deeper than just the deep pocket theory. With the poor audit work exhibited in Grabill, PTL, Terra Drill & Oil, and other engagements, it would seem that Laventhal dug its own grave. In the highly publicized Grabill/Stoecker case, there was evidence that virtually nothing was done to verify the existence of major assets. Indeed to some, it seemed Laventhal would have vouched for anything--if the fee was right.

The reputation of former Laventhal employees will undoubtedly suffer too. Although many of Laventhal's former
partners have found jobs with other accounting firms, these firms will no doubt keep a close watch on these partners to ensure they are capable of doing quality work. But perhaps it is the staff level employees whose reputations will suffer the most. Surrounded by the inadequate work Laventhal was producing, one must wonder how valuable of a learning experience these employees received in their time at Laventhal.

Although it was their involvement with Grabill and William Stoecker which eventually slammed the door shut on Laventhal, this was only one example of numerous problems at Laventhal. Laventhal seemed to be grossly negligent in many of these cases; however, it has become increasingly common for accountants to be named in lawsuits which are not so clear-cut. Indeed in some cases the accountants seem to be pursued only because of their deep pockets. As a result, a number of changes have already begun to take shape within the accounting profession to guard against incompetent work and to protect the firms from frivolous lawsuits. The following pages contain a number of observations and thoughts concerning the condition of today's accounting industry.

**The Expectation Gap Standards.**

The accounting industry needs to find a way to clarify what the public should expect of it, and what it should not. While Laventhal clearly didn't do its job, this is not so obvious in many of the other lawsuits. Just because a client goes bankrupt,
doesn't mean that the auditors haven't done their job or that they should get sued.

What can the industry do about the abundance of lawsuits it is facing today? Well, the recent issuance of the nine "expectation gap" standards seems to be a step in the right direction. In order for someone to sue an accounting firm, there should be a sound basis for determining where the auditors failed in their responsibilities. In the past there has been confusion concerning the auditor's exact responsibilities. The auditor's perception of his or her responsibilities was different than the public's perception. In attempting to clarify this issue, the expectation gap standards resulted in the auditor assuming a higher degree of responsibility than they had in the past. The new standards have increased the auditor's responsibility to detect and report errors, irregularities, and illegal acts. The standards also increase the auditor's responsibility to consider internal control as well as requiring analytical procedures in both the planning and final review stages of the audit. Finally, the standards have changed the language of the auditor's report including "new reporting requirements in the areas of going concern, internal control and audit committees." With any luck, these new standards will clarify to the public the degree of responsibility the auditor has accepted and, hopefully, will help
to reduce the lawsuits against public accounting firms in the future.  

**Peer Reviews.**

More extensive peer reviews can also help identify and eliminate some of the poor practices that are occurring at some accounting firms. While peer reviews are still a fairly new form of regulation in the industry, they are becoming increasingly more common. Peer reviews have now become part of the regulations of the AICPA Division for CPA Firms and, although membership in this organization is still voluntary, firms who register with the Division must meet certain practice requirements and submit to mandatory peer reviews. The practice requirements refer mainly to maintenance of appropriate quality controls and the imposition of sanctions for members failing to meet membership requirements. If peer reviews prove to be effective, perhaps someday they will become mandatory for all firms. With the many audit problems which are unfolding in the S&L scandal and the numerous lawsuits against firms (like Laventhol) where the work didn't seem up to par, perhaps peer review might have highlighted these problems before things got as bad as they did.

**Limited Liability Corporations.**

Another way that auditors might seek to limit their vulnerability to lawsuits is through changing the organizational

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96 Guy and Winters, "Implementing the Expectation Gap Auditing Standards," p. V.
form of accounting firms to limited liability corporations. Perhaps it is not a bad idea to allow the partners to protect at least their personal assets from frivolous suits; however, the corporate form of organization should not be allowed to become a haven to allow the accounting industry to hide from their responsibility to produce high quality work. A distinguishing mark of the auditing profession has been that the partners take a high degree of responsibility for the work of their firms. If modification to the corporate form of organization is viewed as an attempt to shirk their responsibilities, it could adversely affect the public's confidence in the entire industry.

**Not Just the Accountant's Fault.**

It is easy to claim that it was the accountant's fault that Grabill was able to procure so many millions of dollars in loans from banks, but the banks were not without fault. Many of the loans which Stoecker obtained for himself or Grabill were obtained without audited financial statements. Remember, too, that the Bank of New England had loaned Grabill $150 million while requiring no collateral because of Grabill's apparent financial strength. While it is true that Grabill looked like a sound company according to it's poorly prepared financial statements, no bank should lend such sums of money without its own thorough investigation and without collateral. While Laventhol should not be excused for its inadequate work in the Grabill case, the accounting profession cannot be blamed for the shortcomings of other professionals.
It seems almost obvious that many lawsuits are looking to blame the accountants with the "deep pockets" every time a business gets in trouble, and this is simply unfair. This is not to excuse the quality problems that Laventhol exhibited (they should be held accountable for these), but there appears to be many lawsuits where it is unclear as to whether the accountants really did anything wrong. Where the profession has done its job, the profession needs to be guarded against frivolous suits naming accounting firms simply because they have money and insurance.

The Industry Must Not Forget Its Function.

Last, but definitely most important, the Grabill case must remind the accounting industry what it is paid for and relied upon to do: to kick the tires! An auditor's function is to lend credibility to financial statements. An audit should follow generally accepted auditing standards, and when these standards are followed, any accounting firm should be able to render the proper opinion on financial statements. In this way, many people believe that an audit is merely a commodity. In other words, as long as there is an opinion, it should not matter who audited the information. However, with cases like that of Laventhol, the question arises if an audit is merely a commodity or if an opinion from one firm lends more credibility than an opinion from another. It is very embarrassing to the profession that an accounting firm could give an unqualified opinion on financial statements listing company after company that did not exist. One
instance of a Laventhol employee questioning the firm's work was discussed in conjunction with the Terra Drill & Oil case. The public undoubtedly wonders what all the Laventhol "professionals" were doing while so many poor audits were occurring.

The third standard of field work states that "Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination." Theoretically, if an accounting firm gathers evidence to support their opinion, they will not be found negligent even if their opinion later appears to be incorrect. In the Grabill/Stoecker case, however, company after company listed as assets on the financial statements did not even exist. Clearly there was no attempt to collect sufficient competent evidential matter concerning the existence of these assets. If Laventhol had tried to verify the existence of even one of these companies, they should have quickly determined something was wrong. If on the other hand, Laventhol knew the financial statements were materially misstated, and verified them anyway for a high audit fee, this once again badly hurts the reputation of the profession.

The scope paragraph of the independent auditor's report reminds us that "generally accepted auditing standards....require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement." Because auditors work with cost/benefit
constraints, the auditor does not promise to provide absolute assurance that the financial statements are correct. However, professionals in the public accounting industry should not associate themselves with giving even reasonable assurance about the accuracy of financials unless they have done enough work, asked enough questions, and looked at enough evidence to give such an opinion.

Whatever the future may hold, one thing remains sure. Accounting firms need to act now to maintain the reputation of their profession. Accounting firms must be sure that the public understands the degree of responsibility they are taking, and the firms must be sure that their audits provide the degree of assurance that their audit opinion promises. When these things become clear, perhaps then there will not be so many lawsuits against accountants, blaming them for improper opinions and business failures. But while trying to limit their vulnerability to lawsuits, the approach must be to further define the auditors responsibilities, not to develop ways to minimize the responsibility auditors assume. Surely there is a lot to be learned from the problems the accounting industry is now facing. Let us hope that the firms learn from their mistakes to prevent history from repeating itself.
BIBLIOGRAPHY


