

Quantum of loss/ damage due to accounting fraud



Background

Against the backdrop of Covid-19 and discussions of economic loss and business interruption, recent incidents of alleged accounting frauds and fraudulent financial reporting practices have drawn the attention of investors and regulators. Investors who believe they have suffered an investment loss may wish to seek financial remedies.

In this article, we will look at

- examples of red flags;
- what should be considered for quantum of loss and damages in order to determine a claim;
- a case study; and
- lastly, how PwC can help.



Examples of red flags



Business model vs Operation reality

Whether the business model described by management on paper is in line with reality, and makes commercial sense, for example, manufacturers would be expected to have a significant level of assets (such as factories and equipment)



Revenue recognition

Whether the revenue recognition practice is consistent with market norms and commercial substance



Non monetary transactions

Whether the fair value for a transaction (especially non-monetary transaction) is reliably estimated and in particular, whether there has been any independent valuation to support the transaction price



Assets acquisition

Whether the purported acquisition has been carefully examined by the board of directors, with consideration paid supported by a professional valuation



Local vs listed country's statutory reporting vs third party source

Whether there are unexplained discrepancies between reported figures in local and listed country's statutory reporting, compared to those reported by credible third party sources / data measurement providers



Inconsistency of disclosures by transacting parties

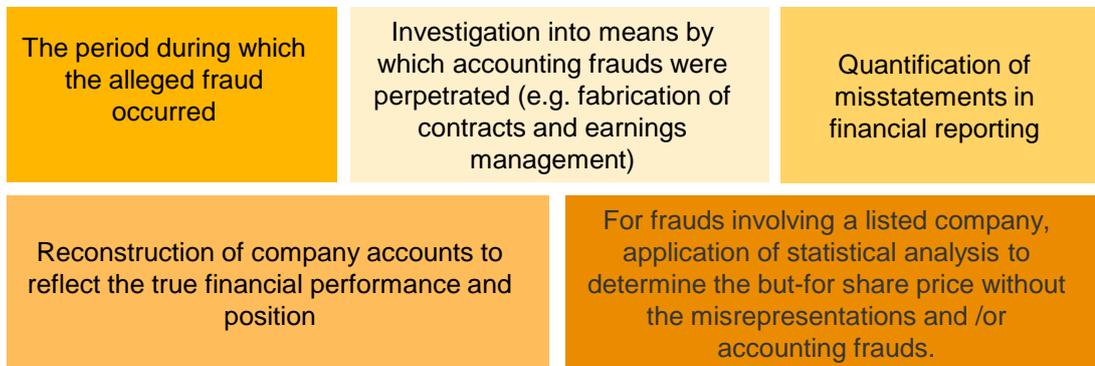
Whether the transaction amounts and details disclosed by the transacting parties in their respective financial statements are consistent

How investors recover their losses

In the event of fraud and corporate misconduct, the amount of claim is case sensitive and there is no one single methodology that can be applied globally. A typical example would be the difference between original investment vs the but-for value in the absence of the fraudulent acts.



The determination of such difference often requires experienced forensic and quantum experts to consider and undertake analyses such as:



Case study – RINO International Corporation



In 2010, RINO International Corporation (“**RINO**”), a US listed Chinese company, primarily operating in environmental protection and remediation, was accused in a short-seller report of committing certain accounting frauds, including:

- Overstatement of 2009 revenue by 94.2%;
- Diversion of tens of millions of dollars from a securities offering by RINO in 2009; and
- Non existence of the claimed customer relationships.

The date after the short-seller report was released, RINO’s share price declined by 28%.

In 2013, the US Securities and Exchange Commission charged RINO, its Chief Executive Officer and Chairman of the Board with engaging in a scheme to deceive the investing public.

Consequences

Eventually, in a related class action settlement in 2013, the Chief Executive Officer and Chairman of the Board of RINO

- agreed to pay USD 3.5 million; and
- were prohibited from serving as officers and directors of a public company for 10 years.

Background

How PwC can help

PwC is a leading valuation practice with a team of dedicated valuation professionals in Mainland China and Hong Kong, and extensive experience in providing litigation support, expert witness testimony and forensic services to resolve disputes.

Regardless of what stage you are at, it is important to consult the right professional. Our valuation team is specialised in providing:

Before the claim assessment process

Damage analysis — cost and benefit of:

- commencing a claim
- settling out of Court
- conducting private arbitration

Litigating a claim

Quantum of loss & damages:

- prepare expert report
- review and critique calculations / report produced by the other side

Preparing for a trial

Assist in trial preparation:

- expert witness testimony
- formulate litigation strategy with legal team
- assist in cross-examination preparation

Contact us



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