

# MADOFF SECURITIES

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# **BERNARD LAWRENCE MADOFF**

- **At first firm traded only securities of small over the counter companies – penny stocks.**
- **Pioneer of electronic securities trading.**
- **Chairman of the NASDAQ (National Association of Securities Dealers Automated Quotations)**

# PONZI SCHEME

- **Lure investors in by guaranteeing unusually high returns.**
- **Used the money from new, incoming investors to pay off the promised returns to older ones.**
- **No real actual profit is being made.**
- **Funds earned an average annual rate of return from 10 to 15 percent - some of them never had a lost even when stock market in 2008 collapsed.**
- **Clients requested a total of \$7 billion back in returns, Madoff only had \$200 million to \$300 million.**

## **WHY SCHEME WORKED?**

- **Hired very small audit firm called Friehling & Horowitz with one accountant David Friehling**
  - **He didn't report any audits, as result he was not required to submit to AICPA peer review**
  - **SEC started investigate firm after Madoff confession not after series of complaints filed by individual Harry Markopolos.**
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# RED FLAGS

- **Madoff refuse to allow the big four auditors to review his financial reports.**
  - **Auditing the firm by one auditor.**
  - **Firm didn't provide to clients online access to their accounts just account statements by mail.**
  - **If such as investment strategy existed, it would be Holy Grail of investing.**
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# QUESTIONS

**Q1: Research recent developments involving this case-**

**Q2: Suppose that a large investment firm had approximately 10 % of its total assets invested in funds managed by Madoff Securities. What audit procedures should the investment firms independent auditors have applied to those assets?**

**Q3: Describe the nature and purpose of a “peer review”- Would peer reviews of Friehling & Horowitz have likely resulted in the discovery of the Madoff fraud? Why or why not?**

**Q4: Difference between a fraud “condition” and a “fraud risk factor”.**

**Q5: In addition to the reforms mentioned in this case recommend other financial reporting and auditing – related reforms that would likely be effective in preventing or detecting frauds similar to that perpetrated by Madoff.**