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THE COST OF CORPORATE FRAUD

Researchers from the University of Toronto, the University of California at Berkeley and the University of Chicago recently published a study using statistical analyses to determine the prevalence of corporate fraud.¹

The researchers attempted to answer an important question: “Is the fraud we observe the whole iceberg or just its visible tip?” Their study endeavored to answer this question by estimating the ratio of the “exposed tip to the submerged portion” to determine the “hidden prevalence of fraud.”

To calculate that ratio, the study uses a few approaches previously employed by other academics. However, it also introduced a novel approach based on a natural experiment made possible by the demise of auditing firm Arthur Andersen (AA) in the wake of the Enron scandal in the early 2000s.

As background, the Enron accounting scandal came to light in 2001. Later that year, *The New York Times* ran an article with the headline “From Sunbeam to Enron: Andersen’s Reputation Suffers,” reporting that former AA clients were under enhanced scrutiny for fraud.

The researchers described their methodology, stating, “the simple idea is that after the AA demise, former AA clients were subject to vastly increased scrutiny” from new auditors and other fraud detectors—including “the

media, investment intermediaries, short-sellers, and their internal gatekeepers”—with strong incentives to uncover any fraud committed by former AA clients.

Based on statistical analyses of former AA clients before, during and after this period of enhanced scrutiny, the researchers concluded that “fraud is indeed like an iceberg with significant undetected fraud beneath the surface.” Indeed, they determined that:

- ◆ **Two out of three** corporate frauds go undetected,
- ◆ **10 percent** of large corporations commit securities fraud each year, and
- ◆ The costs borne by equity holders in companies involved in fraud totaled approximately **\$830 billion** in 2021 alone.

Labaton Sucharow’s lawyers are available to address any questions you may have regarding these developments. Please contact the Labaton Sucharow lawyer with whom you usually work or the contacts below.

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¹ Alexander Dyck, et al., [How pervasive is corporate fraud?](#), Rev. Acct. Stud., Jan 5, 2023.