AUDITORS' DUTY TO DETECT AND TO RESPOND TO "RED FLAGS" INDICATIVE OF SECURITIES FRAUD: A CASE STUDY OF TAYLOR V. ROTHSTEIN KASS & CO., PLLC

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Abstract

This is a case study of Taylor v. Rothstein Kass & Co. It covers: (a) legal elements of a securities fraud claim; (b) red flags which may be indicative of securities fraud; (c) legal elements of a claim of an auditor's professional negligence ; (d) the limitations period in an auditor's professional negligence case; (e) effect of illegal activity of a client's officers or directors on the professional negligence limitations period; (f) the pleading of causation of an auditor in a professional negligence case; (g) an auditor's potential liability for aiding and abetting breach of fiduciary duties by the client's officers or directors; (h) state anti-fracturing rules and their effect on auditor tort liability; (i) legal elements of a common law fraud claim; (j) the heightened pleading requirement in a fraud case; (k) legal elements of a fraudulent conveyance claim; (l) the applicability of a statute of repose on a fraudulent conveyance claim; (m) the pleading of facts evidencing fraudulent intent in a fraudulent conveyance case; (n) a party's duty to exhaust all administrative remedies before attempting to depose the Securities and Exchange Commission; and (o) the remedy of disgorgement of all money reaped as a result of the fraud in a securities fraud case.

Keywords: auditor, duty, red, flags, securities, fraud, negligence, fiduciary

1. General Problem

This is a legal case study of *Taylor v. Rothstein Kass & Co.* This study reveals the impact of an unqualified audit opinion upon a securities fraud case brought against the CEO of the audit client. It also shows how the presence of "red flags" indicative of securities fraud may be used in a professional negligence case against an auditor.

2. Review of the Literature: "Red Flags" Indicative of Illegal or Unethical Activity of a Business Firm

Jaba (2012) investigated the risk of fraud in reference to the fraud triangle factors and financial indicators that the literature often refers to as "red flags;" the study showed that a business firm's risk of fraud is primarily influenced by its degree of financial leverage. Stanistic (2013) studied red flags indicative of financial trouble in the banking sector of Serbia; he emphasized the importance of auditor independence and external audits as a means of providing confidence to stakeholders in those banks. Amaechi (2013) explored the use of financial ratios to detect fraud in the Nigerian banking system; regression analysis showed that 16 of 29 financial ratios tested were statistically significant indicators of fraud in the financial statements of banks. Varma (2013) demonstrated how to use an Excel sheet to perform Benford distribution statistical tests as

an effective tool for locating red flags in suspected data pertaining to business firms in a supply-chain network. Abdullatif (2013) explored how CPA firms in Jordan modify their audit plan whenever red flags indicate a greater risk of fraud in audit clients; the most important fraud risk factors were the attributes of the client's management and their attitude towards the audit. Kassem (2014) proposed a framework for external auditors to help them properly assess and respond to red flags associated with asset misappropriation, a type of fraud which has received less attention in the literature. Using questionnaire data, Bazrafshan (2016) compared perceptions of fraud risk factors between auditors and university students; he found that both groups believe the most important red flags indicative of fraud are degree of dependence of managers' salaries on operating results of the firm, and management's lack of supervision over subordinates in implementation of internal controls. Grenier (2017) provided evidence that, under common audit conditions, an auditor's degree of industry specialization inhibits some aspects of his professional skepticism; his study finds that audit firm efforts to promote professional skepticism are more effective for specialists as non-specialists are skeptical regardless of these efforts. Pazarskis (2017) researched 12 Greek firms that committed financial statement fraud during 2008-2015 and used 12 other, non-fraudulent firms as a control sample; he developed a model using financial ratios than can be used to analyze financial statements for fraud, with an accuracy rate exceeding 90 percent. Del Magro (2017) studied red flags that can be used to assess a business firm's fraud risk; in a sample consisting of 51 internal auditors working in credit unions in Brazil, he found that they attributed greater importance to red flags relating to operational activities and internal control procedures. Varma (2017) explored how Enterprise Resource Planning systems can be used to detect fraud relating to a business firm's vendors, red flags pertinent to vendor fraud and types of vendor fraud; the article emphasized giving greater attention to ensuring that potential fraudsters do not get access to the firm's vendor master file. Huang (2017) identified financial statement fraud detection factors using the fraud triangle risk elements; the most important dimension was shown to be "pressure/incentive" and the least one was "attitude/rationalization," and the top 5 determinants of pressure/incentive were poor performance, the need for external financing, financial distress, insufficient board oversight, and degree of competition or market saturation. Utami (2020) investigated red flags indicative of fraud in 14 Indonesian banks; the results showed that internal controls and organizational culture had a significant positive effect on early detection of fraud. Safta (2020) looked at the manipulation of financial statements as a significant red flag indicative of potential fraud; using data from 62 Romanian business firms, the researcher found that 84% of the firms in the study manipulated their financial statements, with the greatest amount of manipulation occurring in the fields of tourism, construction, trade and transport. Brazel (2021) found that when managers identify red flags in the financial statements under their review, they have greater concern over earnings quality; when red flags are present, managers are more likely to report those both to their CEO and to the external auditor. In a legal case study, Blythe (2021, KPMG case) explored whether red flags ignored by the auditor, coupled with the auditor's violation of Generally Accepted Auditing Standards, were sufficient grounds to deny the auditor's motion to dismiss the securities fraud case against him; the court answered this question in the affirmative, but only if the red flags were significant, and the court held the red flags were insufficient in that case. In another legal case study involving alleged securities fraud, Blythe (2021, Aegean Marine case)

Vol. 5, No.08; 2021
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noted that the court had found 13 red flags which should have alerted the auditor to the possibility of the client's fraud, that the auditor had exhibited "willful blindness" in not responding to those red flags, and the auditor's motion to dismiss the case was denied.

Missing from the literature is a study of a recent legal case covering all of these factors: securities fraud, red flags indicative of securities fraud, auditor's professional negligence, auditor's common law fraud, auditor's breach of fiduciary duties, auditor's aiding and abetting breach of fiduciary duties, and auditor's fraudulent conveyance. This study includes all of those factors and will enrich the literature.

3. Specific Objectives

The objectives of this article are to: (a) explain the elements of a case of securities fraud pursuant to the Securities Exchange Act of 1934; (b) give examples of types of red flags an auditor should be aware of that may be indicative of securities fraud; (c) explain the elements of a case of professional negligence against an auditor; (d) state the limitations period in a professional negligence action against an auditor, and explain when it ordinarily begins to run; (e) explain the effect of illegal activity of the officers or directors of a corporate client upon the limitations period; (f) describe how a plaintiff can plead causation of an auditor in a professional negligence case; (g) state whether an auditor can be liable for aiding and abetting breach of fiduciary duties merely by issuing unqualified audit opinions; (h) explain what is meant by a state's anti-fracturing rule, and state whether a plaintiff's claim that an auditor participated in breaches of fiduciary duties should be automatically dismissed because of a state's anti-fracturing rule; (i) explain the elements of common law fraud applicable in most U.S. states; (j) describe the heightened pleading requirements in fraud cases; (k) explain the elements of a claim under the Texas Uniform Fraudulent Conveyance Act; (l) explain the statute of repose in a fraudulent conveyance case and when the limitations period begins to run; (m) explain the plaintiff's burden to plead facts evidencing fraudulent intent in a fraudulent conveyance case; (n) consider whether a party in a securities fraud case may be allowed to depose the Securities and Exchange Commission, and the party's duty to exhaust administrative remedies before taking judicial action; and (o) discuss the disgorgement of all money received as a result of the fraud as a remedy for those found liable of securities fraud.

4. Background: Facts of the Case

Christopher Faulkner (Faulkner) was the CEO of Breitling Energy Corporation and Breitling Oil & Gas Corporation (hereinafter, collectively Breitling); both are U.S. firms. From 2011 to 2016, Faulkner used the Breitling firms to raise $150 million in gross proceeds from investors through the offer and sale of oil and gas-related securities. Beginning in 2011, Faulkner and several of his subordinates orchestrated a massive scheme that defrauded the Breitling stockholders of $80 million. Faulkner, while misrepresenting his education and experience, sold "working investments" in various oil and gas prospects through his companies. Faulkner oversold the available units for each project and inflated the estimated cost to be incurred. Despite representing to investors that their funds would be segregated, Faulkner and his companies commingled and misappropriated significant portions of this money through tens of millions of

Vol. 5, No.08; 2021

ISSN: 2456-7760

dollars in cash disbursements and reimbursements of Faulkner's personal expenditures. Throughout the scheme, Faulkner signed, and Breitling filed, inaccurate and misleading financial reports with the U.S. Securities and Exchange Commission (SEC); these reports included audited financial statements. Investors in Faulkner's companies ultimately received only a small fraction of their investment principal (Faulkner case 1, p. 3).

In 2016, the SEC filed a lawsuit against Faulkner and his co-conspirators, alleging they committed securities fraud by violating the Securities Act of 1933 s 17(a), the Securities Exchange Act of 1934 s 10(b) and SEC Rule 10b-5. The elements of a securities fraud case pursuant to the Exchange Act are: (a) a materially false statement of defendant contained in a document filed with the SEC; (b) the false statement was relied upon by plaintiff; and (c) this caused plaintiff's financial loss (Faulkner case 1, pp. 4-5).

After the SEC filed the lawsuit, Faulkner brazenly continued to defraud Breitling's stockholders by pilfering $110,000 in production revenue checks from gas and oil operators payable to Breitling that should have been used to make payments to stockholders. In 2017, the SEC asked the court for an injunction against Faulkner, to freeze Breitling's assets and to appoint a receiver over those assets. In response, the court issued an order granting an injunction, ordered the assets to be frozen and appointed a receiver, Thomas L. Taylor (Taylor) over those assets (Faulkner case 1, pp. 4-5).

From 2011 to 2014, Breitling's auditor had been Rothstein, Kass & Co., PLLC (Rothstein). During the fraud, Rothstein had audited Breitling's financial statements and had issued an unqualified opinion on those statements; the audited financial statements were filed each year with the SEC. Taylor, the court-appointed receiver, sued Rothstein and asserted claims for professional negligence, breach of fiduciary duty, fraud, and fraudulent transfers. In response, Rothstein filed a motion for the court to dismiss the lawsuit for failure to state a claim on which relief could be granted. The court granted the motion in part and denied the motion in part and granted Taylor leave to replead one of the claims (Rothstein case 1, p. 1).

5. What were the red flags that should have alerted Rothstein to the possibility of fraud?
There were materially misleading cost estimates in private placement memoranda, commingling of investor proceeds, overselling of interests in numerous offerings, massive reimbursements to Faulkner, and the total absence of internal controls. Notwithstanding all of this, Rothstein issued clean, unqualified audit opinions on Breitling's financial statements (Rothstein case 1, p. 3).

6. Should Taylor's professional negligence and gross negligence claims against Rothstein be dismissed because they are time-barred pursuant to the statute of limitations?
No. In its motion to dismiss, Rothstein stated that the negligence and gross negligence claims should be dismissed because of the statute of limitations. Under Texas law, the statute of limitations for negligence actions is two years. The limitations period begins to run when the claimant discovers or should have discovered through the exercise of reasonable care and diligence the facts establishing the elements of his cause of action. Prior Texas case law has held

Vol. 5, No.08; 2021

ISSN: 2456-7760

that this discovery rule applies to professional negligence claims against auditors. Rothstein is asserting that the discovery of the fraud should be imputed to Breitling because its CEO, Faulkner, had knowledge of the massive fraud since 2011. However, Taylor maintained that the knowledge of a controlling principal who is engaged in fraud is not imputed to the subordinate entities (Breitling) and that those claims cannot accrue until a receiver is appointed. The court agreed with Taylor, stating where a plaintiff can show that the officer was acting adversely to the corporation and entirely for his own purpose, the limitations period must be tolled. According to, Rothstein's motion to dismiss the negligence and gross negligent claims was denied (Rothstein case 1, pp. 5-8).

7. Should Taylor's professional negligence claim against Rothstein be dismissed because Taylor failed to plead causation?

No. To establish liability for professional negligence under Texas law, the plaintiff must show the existence of a duty, a breach of that duty, and damages arising from the breach, as well as privity of contract. Also, there must be proof of proximate cause. Proximate cause includes two elements: (a) foreseeability; and (b) cause in fact, which means that the act or omission was a substantial factor in bringing about the injury and without which no harm would have occurred. In this case of professional negligence of an auditor, Taylor is required to prove that Breitling relied upon Rothstein's audits of their financial statements (Rothstein case 1, pp. 8-9).

Rothstein contended that Taylor failed to plead any factual allegations that Breitling relied upon the audited financial statements or that those statements assisted Faulkner in the perpetuation of his fraudulent scheme. Taylor responded that causation is a question of fact that should not be decided at the pleading stage. He also stated that his pleadings allege that Breitling relied upon the accuracy of the audit opinion, and that the audited financial statements filed with the SEC constitutes sufficient evidence of reliance (Rothstein case 1, pp. 10-12).

The court concluded that Taylor had adequately pleaded that Breitling relied upon the audited financial statements. The court noted that Breitling engaged Rothstein to audit its financial statements in anticipation with Faulkner's taking those entities public through a reverse merger. Citing Taylor's complaint, the court noted that if Rothstein had exercised even a minimum level of the independence, inquiry and professional skepticism required of auditors, then Rothstein would have revealed the fraudulent scheme many years ago, saving Breitling tens of millions of dollars in losses that would not otherwise have occurred. Accordingly, the court held that causation had been adequately pleaded and Rothstein's motion to dismiss was denied (Rothstein case 1, pp. 12-13).

8. Should Taylor's claim that Rothstein aided and abetted a breach of fiduciary duties be dismissed?

Yes. In his complaint, Taylor alleged that Rothstein aided and abetted CEO Faulkner's breach of fiduciary duties by issuing unqualified audit opinions, thereby enabling Faulkner to defraud the Breitling stockholders of millions of dollars. However, the Supreme Court of Texas has not expressly decided whether Texas recognizes a cause of action for aiding and abetting a breach of

Vol. 5, No.08; 2021

ISSN: 2456-7760

fiduciary duties. Since this tort does not exist under Texas law, this claim must be dismissed (Rothstein case 1, pp. 13-14).

9. Should Taylor's claim that Rothstein participated in breaches of fiduciary duties be dismissed because it violates Texas' anti-fracturing rule?

No. In its motion to dismiss, Rothstein contended that Taylor's claims for participation in tortious conduct violate Texas' anti-fracturing rule. Under Texas law, whether allegations against a professional labeled as breach of fiduciary duty, fraud, or some other cause of action, are actually claims for professional negligence or something else is a question of law to be determined by the court. Texas courts apply the anti-fracturing rule to prevent plaintiffs from converting what are actually professional negligence claims against a professional (such as an auditor) into other claims such as fraud, breach of contract, or breach of fiduciary duty. Although the anti-fracturing rule does not necessarily foreclose the simultaneous pursuit of a negligence-based malpractice claim and a separate breach of fiduciary duty or fraud claim where there is a viable basis for doing so, the plaintiff must do more than merely reassert the same claim for professional negligence under an alternate label. He must present a claim that goes beyond what traditionally has been characterized as malpractice, i.e., the pleaded facts must demonstrate that his additional claims cannot be reduced to mere negligence (Rothstein case 1, pp. 14-19).

Rothstein stated that all of Taylor's claims pertained to the quality or adequacy of the audits, and that all of the claims could be reduced to professional negligence. However, the court held that Taylor had presented a claim that goes beyond mere negligence. Taylor alleged that, despite knowledge of the fraud or red flags that put it on notice of the truth, Rothstein issued clean audit opinions that did not accurately represent the true condition of Breitling. In his complaint, Taylor asserts that, in December 2013, less than three months into Rothstein's audit of Breitling, Rothstein had knowledge sufficient to place it on notice of the true nature of Faulkner's conduct and his fraud scheme. Taylor further alleged eight specific issues known to Rothstein to support his contention that Rothstein had knowledge that it should not have issued an unqualified audit opinion. Taylor has not simply recast, and thereby fractured, a professional negligence claim based on what Rothstein allegedly failed to do. Instead, Taylor's allegations that Rothstein issued an unqualified opinion despite knowledge of its falsity exceed what is typically characterized as negligence, and supports a separate claim for participation in breaches of fiduciary duties. Accordingly, the court denied Rothstein's motion to dismiss Taylor's claims that Rothstein participated with Faulkner in breaches of fiduciary duties (Rothstein case 1, pp. 14-19).

10. Should Taylor's claim that Rothstein participated with CEO Faulkner in a scheme to defraud the company be dismissed?

Yes. The elements of common law fraud in Texas are: (a) a material representation was made; (b) it was false when made; (c) the fraudster either knew it was false, or made it without knowledge of its truth; (d) the fraudster made it with the intent that it should be acted upon; (e)
the victim acted in reliance; and (f) the victim was injured as a result. In Texas, each party to a fraudulent scheme is responsible for the acts of the others done in furtherance of the fraudulent

scheme. A party may also become liable for fraud without making any fraudulent representations if he participates in the fraudulent transactions and reaped the benefits (Rothstein case 1, p. 19).

In a state law fraud claim, there are heightened pleading requirements. The plaintiff is required to state specific facts that support each of the six elements of fraud. The plaintiff is required to allege the particulars of time, place and contents of the false representations, the identity of the person making the representation and what he gained thereby. In other words, plaintiff is required to plead the "who, what, when, where and how" of the fraud (Rothstein case 1, p. 20).

In this case, plaintiff Taylor stated that Rothstein is liable for "participation in a fraudulent scheme" and that the auditor's services enabled CEO Faulkner to fraudulently offer securities to public investors and caused Breitling to incur tens of millions of dollars in losses. However, since Texas does not explicitly recognize a cause of action for aiding and abetting fraud, it is not clear that Texas law recognizes a cause of action for "participation in fraud" that is separate from a direct claim for fraud or conspiracy. In other words, it is questionable whether it is sufficient to allege that the auditor assisted or participated in another's fraud without adequately pleading that the auditor itself engaged in fraudulent conduct with the requisite knowledge and intent. In this case, plaintiff Taylor does not explicitly address the elements of fraud or clarify which of the auditor's representations or omissions gives rise to fraud as opposed to negligence. Taylor merely contends that the complaint contains specific allegations describing Faulkner's use of Breitling to engage in fraud. But allegations of Faulkner's fraud are insufficient to hold auditor Rothstein liable for fraud absent specific allegations of Rothstein's fraudulent intent and acts. Although the auditor's issuance of clean audit opinions despite its knowledge of significant issues in the company, may suggest that Rothstein acted with intent to defraud, it is not enough. Taylor's failure to plead the six elements of fraud and to state which representations were material, false, and made with fraudulent intent to induce action or reliance, means that he has failed to satisfy the heightened pleading standard for fraud. The court dismissed plaintiff's claim that auditor Rothstein had committed fraud (Rothstein case 1, pp. 20-24).

11. Should Taylor's claim that Rothstein made a fraudulent conveyance be dismissed pursuant to the statute of repose?

No. In his lawsuit, Taylor asserts that the audit fees paid to auditor Rothstein from December 1, 2013 to April 1, 2014 were fraudulent conveyances and that Taylor is entitled to recover those funds pursuant to the Texas Uniform Fraudulent Transfers Act (TUFTA). TUFTA contains a 4-year statute of repose which ordinarily would mandate that fraudulent conveyance actions must be filed within four years after they occur. However, an exception applies in this case; the limitations period will not begin to run upon the discovery of the transfer alone, but only when the claimant discovers or reasonably could have discovered the fraudulent nature of the conveyance. Accordingly, the court denied Rothstein's motion to dismiss the fraudulent conveyance claim pursuant to the statute of repose (Rothstein case 1, pp. 24-28).

12. Should Taylor's claim that Rothstein made a fraudulent conveyance be dismissed because Taylor failed to allege facts evidencing fraudulent intent?

No. To establish a claim under TUFTA, a plaintiff must prove: (a) he is a creditor with a claim against a debtor; (b) the debtor transferred assets after, or a short time before, the plaintiff's claim arose; and (c) the debtor made the transfer with the intent to hinder, delay or defraud the plaintiff. Fraudulent transfer claims require actual intent and have a heightened pleading standard. Auditor Rothstein contends that Taylor did not sufficiently allege facts to allow the reasonable inference that Faulkner or Breitling acted with fraudulent intent when they paid Rothstein to conduct the audit. The court agreed, holding that Taylor did not adequately allege Faulkner's fraudulent intent in his payment to auditor Rothstein. Instead, Taylor made only generalized allegations which do not meet the standard of the heightened pleading requirement. However, the court did not dismiss Taylor's fraudulent conveyance claim; instead, the court gave Taylor leave to amend his pleadings and thereby gave him an opportunity to comply with the heightened pleading requirement (Rothstein case 1, pp. 28-32).

13. Did Rothstein have the right to depose the SEC in this case?

Maybe. Rothstein asked the court for an order compelling the SEC to submit to a deposition. Rothstein stated it should be allowed to depose the SEC because Rothstein's audit triggered the SEC's lawsuit against Faulkner, which is an important factor in Taylor's damages calculations. The SEC responded that Rothstein has failed to exhaust its administrative remedies under the Administrative Procedure Act (APA). The court agreed that Rothstein had not exhausted its administrative remedies because Rothstein has not yet petitioned the SEC to review its decision not to comply with Rothstein's subpoena. Accordingly, the SEC's decision is not a final agency action that is subject to judicial review. Once Rothstein does petition the SEC to review its decision, and the SEC makes a determination on that matter, then it will become a final agency action that is subject to judicial review. If the SEC's final decision is to refuse to comply with Rothstein's subpoena, then Rothstein may once again ask the court to compel the SEC to submit to a deposition (Rothstein case 2, pp. 14-15).

14. What was the final outcome in this case?

Receiver Taylor's case against the auditor, Rothstein, is ongoing.

In *SEC v. Faulkner*, the court entered judgment against three of CEO Faulkner's co-conspirators on January 8, 2021. The court concluded that the SEC had met its burden of showing that the sums of $1,901,480 for Hallam, $1,454,533 for Miller, and $838,950 for Handkins are a reasonable approximation of net profits connected to each of these defendant's securities violations. These co-conspirators must pay those sums to the receiver, Taylor (Faulkner case 2, p. 10).

The SEC's case against the mastermind of the fraud, CEO Faulkner, is ongoing.

15. Conclusions

Vol. 5, No.08; 2021

ISSN: 2456-7760

a. The elements of a securities fraud case pursuant to the Securities Exchange Act are: a materially false statement of defendant contained in a document filed with the SEC; the false statement was relied upon by plaintiff; and this caused plaintiff's financial loss.

b. Red flags that may be indicative of securities fraud include: materially misleading cost estimates in private placement memoranda, commingling of investor proceeds, overselling of interests in securities offerings, massive reimbursements to the CEO, and the total absence of internal controls.

c. To establish liability for professional negligence, a plaintiff must show the existence of a duty, a breach of that duty, and damages arising from the breach, as well as privity of contract. Also, there must be proof of proximate cause. Proximate cause includes two elements: foresee ability, and cause in fact.

d. In Texas and many other U.S. states, the statute of limitations for negligence actions is two years. The limitations period begins to run when the claimant discovers or should have discovered through the exercise of reasonable care and diligence the facts establishing the elements of his cause of action. Prior Texas case law has held that this discovery rule applies to professional negligence claims against auditors.

e. In Texas and many other U.S. states, if a plaintiff can show that a corporate officer or director was acting adversely to the corporation and entirely for his own purpose, the limitations period for professional negligence actions against auditors may be extended.

f. In the professional negligence claim in this case, the plaintiff pleaded the auditor's causation by stating that if Rothstein had exercised even a minimum level of the independence, inquiry and professional skepticism required of auditors, then Rothstein would have revealed the fraudulent scheme many years ago, saving the client tens of millions of dollars in losses.

g. The auditor's issuance of unqualified opinions in this case was insufficient justification for plaintiff's claim that the auditor had aided and abetted the fraudster CEO's breach of fiduciary duties. Texas does not recognize the tort of aiding and abetting breach of fiduciary duties.

h. A plaintiff's claim that an auditor participated in breaches of fiduciary duties should not necessarily be dismissed because of violation of a state's anti-fracturing rule. In this case, the court ruled that plaintiff's claims of breach of fiduciary duties by the auditor went beyond mere negligence, and the court allowed both claims (negligence and breach of fiduciary duties) to proceed against the auditor.

i. The elements of common law fraud in Texas and many other U.S. states are: (a) a material representation was made; (b) it was false when made; (c) the fraudster either knew it was false, or made it without knowledge of its truth; (d) the fraudster made it with the intent that it should be acted upon; (e) the victim acted in reliance; and (f) the victim was injured as a result. In

Texas, each party to a fraudulent scheme is responsible for the acts of the others done in furtherance of the fraudulent scheme. A party may also become liable for fraud without making any fraudulent representations if he participates in the fraudulent transactions and reaped the benefits.

j. Fraud claims have a heightened pleading standard. In this case, the fraud claim against the auditor was dismissed because the plaintiff had failed to state with particularity how the auditor's acts or omissions satisfied the elements of fraud. In other words, the heightened pleading standard was not met.

k. To establish a claim under the Texas Uniform Fraudulent Conveyance Act, a plaintiff must prove: he is a creditor with a claim against a debtor; the debtor transferred assets after, or a short time before, the plaintiff's claim arose; and the debtor made the transfer with the intent to hinder, delay or defraud the plaintiff. Fraudulent transfer claims require actual intent and have a heightened pleading standard.

l. Ordinarily, the statute of repose is four years in a fraudulent conveyance case. However, in this case, the court held that the limitations period would not begin to run until the plaintiff could have reasonably discovered the fraudulent nature of the transfer to the auditor from Faulkner.

m. In a fraudulent conveyance claim, plaintiff has the burden to plead facts evidencing fraudulent intent of defendant. In this case, the court held that plaintiff had not met this burden. However, the court did not dismiss this claim; instead, the court gave plaintiff an opportunity to re-plead his complaint.

n. In a securities fraud case, an auditor alleged to have been negligent may be allowed to depose the Securities and Exchange Commission. However, before this deposition will be considered, the auditor must have exhausted all administrative remedies. In this case, the auditor had not exhausted all of its administrative remedies, so the deposition was not allowed.

o. In a securities fraud case, individuals found liable will be disgorged from all of the money they reaped as a result of the fraud. A judgment was entered against three of CEO Faulkner's co-conspirators and they were ordered to pay millions of dollars to the plaintiff receiver.

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