White Collar Fraud: A Case Study of KOSS

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Abstract

Fraud does not draw community and political reaction like other crimes (Chapman & Smith, 2001) yet many believe that fraud can be as serious or even more serious than certain types of street crimes (Rebovich & Kane, 2002). The financial statement fraud of KOSS, an American company of more than $34 million was discovered in 2009 after the tipoff from American Express to Michael Koss, CEO. The fraud was significant relative to the size, turnover and profit of the organization perpetrated by senior accounting professional (white collar). KOSS would be classified as an SME and this fraud emphasizes that it is not only large organizations that need to be vigilant regarding accounting frauds and internal controls, but smaller companies as well. Because of its size, KOSS had little segregation of duties and, as was later revealed, massive weaknesses in internal controls. The external auditors, (Grant Thornton, LLP or “GT”) upon whom management were relying, did not have a full understanding of the business and clearly did not meet the expectations of senior management. It is also appeared that auditors failed to apply required audit standards during the audit. Later on, the external auditors agreed to pay KOSS compensation worth $8.5 million in July 2013 as a settlement.

The board of directors including audit committee appeared to be unconcerned regarding effective internal controls, risk management and (wrongly) assumed that they could trust their senior executive staff. The board’s limited policy of ethics and compliance was outdated and did not include a whistleblowing policy. There was no internal audit function reporting to the
board. Further, the computerized accounting system was outdated and lacked the application controls found in more modern applications. The purpose of this case study is to analyze what went wrong at KOSS, who was involved in fraud and how such kind of frauds can be avoided in future.

Keywords: Accounting fraud, Internal control, Audit committee, Risk management, White collar fraud, Whistleblowing policy