Bernard Madoff’s ‘Ponzi Scheme’:
Fraudulent behaviour and the Role of Auditors

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Abstract
A Ponzi scheme is a serious financial crime where an individual or organisation pays returns to its financiers from new capital paid by new financiers, rather than from profit earned. This paper explains the world’s largest and longest Ponzi scheme, Bernard Madoff’s Scandal. The study applies the Fraud Triangle concept to examine the famous scandal involving Bernard Madoff. It explains the underlying opportunity, motivation and rationalisation behind Madoff’s fraudulent behaviour followed by identifying the auditor’s role and expected responsibility. The study corroborates that it might be a combination of Madoff’s desire to maintain his fame and luxurious lifestyle, self-deceiving belief, and his seizure of the opportunity – as the primary cause of this scandal. Additionally, the failure to conduct fundamental audit procedures by the auditor further fuelled this scheme. Auditors may be able to detect fraud at an early stage by becoming sceptical when performing their duties.

Key Words: Fraud Triangle, Role of Auditors, Madoff’s Scandal, Ponzi scheme.

1. INTRODUCTION
When it was discovered that Bernard Madoff’s asset management unit was, in fact, a massive Ponzi scheme, this news immediately shocked the global economy and became the world largest financial fraud ever committed in history. Madoff had liabilities of approximately US$65 billion and was sentenced to 150 years in prison with restitution of US$17 billion (Frank et al., 2009). In order to understand what triggered and caused Madoff to commit the fraud, this study analyses the case based on the Fraud Triangle concept. The role and responsibility of auditors in preventing and controlling fraud in Madoff’s case is also discussed.
The motivation for this research comes from identifying what happened to the world’s largest and longest-lasting Ponzi scheme. We, as a community, should learn from it and prevent a similar instance from happening again in the future. Fraud in the corporate world, no matter how it is executed, leads to grave consequences in that harm is not only done to related parties but also to numerous innocent victims. Since prevention is always better than cure, it is essential for audit professionals to detect such risk factors early, and to stop them before the fraud actually happens. Every time a fraud is unveiled, the role and responsibilities of accountants who audit that firm should be questioned.

Much of our contemporary understanding of preventative measures of fraud centre around the Fraud Triangle in which the three must-have elements of fraud engagement are incentives, opportunities and rationalisations. This idea was first put forward in an article by Donald R. Cressey and Edwin Sutherland in November 1951 titled, “Why Do Trusted Persons Commit Fraud? A Social-Psychological Study of Defalcators”. However, it was Steve Albrecht who first started calling the three elements a “Fraud Triangle” (Albrecht, 2014). The Fraud Triangle describes three factors that are present in every situation of fraud. By using the Fraud Triangle this study will answer the questions: How did Madoff manage to conduct a huge fraud scheme for so many decades without being questioned by any of the investors? And what role did auditors play in Bernard Madoff’s scandal?

The remainder of this paper is organised as follows: the next section discusses the background of the Bernard Madoff scandal. It is followed by a discussion on the Ponzi scheme in section 3. Section 4 discusses the case under the lens of the Fraud Triangle. The role of auditors is outlined in Section 5. Finally, the results and conclusion are presented in Section 6.

2. BACKGROUND OF THE BERNARD MADOFF SCANDAL
The Bernard Madoff scandal is considered to be one of the worst white-collar crimes of all time (Henriques, 2012). By running the largest Ponzi scheme in history, Madoff had tricked his investors by paying them extraordinarily high returns out of their own money.
or that of other investors without having engaged in any actual or effective activity to create a profit. Years previously, Bernard Madoff founded his firm, Bernard Madoff Investment Securities (BMIS), in 1960 with his savings from his lifeguarding career and borrowings from his father-in-law (Hurt, 2009). During the next four decades, Madoff’s firm kept growing and gained a reputation on Wall Street as one of the largest buying and selling market makers at the NASDAQ. Surprisingly, on December 11, 2008, it turned out that the advisory business, part of BMIS, was simply a lie. Based on financial statements as at December 2008, the advisory business serviced almost 5,000 client accounts with client funds of almost $65 billion. However, it has since been revealed that only about $17.3 billion of this had actually existed (Hurt, 2009). Moreover, it appeared that the fund might not have ever conducted any legitimate business to generate earnings. The scheme had been going on for around 20 years by the time it was uncovered due to the consequences of the Global Financial Crisis. After the collapse of the finance market in the fall of 2008, many investors wanted to redeem the huge sums of money that they had invested in year after year, which resulted in claims of redemption of up to $7 billion from investments that did not exist (Drew, 2010).

If we look back to Madoff’s background – his resumé was spotless. He was a former chairman of the NASDAQ and sat on several industry association boards and he had family members who occupied key positions in the company. He even donated to charities and politicians. Investors were blinded by the resumé, his perceived wealth, and his lofty status in the community and therefore did not feel the need to dig beneath the surface when conducting due diligence. Furthermore, investors knew that if they asked too many questions and angered him, he would tell them that he did not want them as a client. Psychologically, he had designed the perfect fly trap (Carozza, 2009). The banks, according to Madoff, never pushed further for more information beyond the false return statements they had received (Pavlo, 2011).

Most the major positions in Madoff’s company were occupied by his family members. Peter Madoff, Bernard Madoff’s brother was the Chief Compliance Officer. Mark Madoff and Andrew Madoff, Bernard’s two sons, worked in the trading arm in the New York office, and were in charge of fund raising for the company (Henrique, 2012).
Furthermore, Bernie Madoff’s auditing was executed by an unknown accounting firm which turned out to have only three staff members: a partner, an accountant, and a secretary. Obviously the so-called ‘external auditor’ existed in name only. Bernard Madoff was in charge of all major roles – he was the real sole decision-maker, the transaction executer, the assets manager, and the financial report writer (Drew, 2010).

The revealed facts eventually led to Madoff being found guilty of 11 federal felony charges including charges of securities fraud, money laundering, and perjury. Thousands of wealthy clients, philanthropic organisations, and middle-class people whose pension funds found their way into Bernie’s investment fund lost their life savings.

3. PONZI SCHEME; THE ORIGIN AND THE LARGEST

A Ponzi scheme is defined as a fraudulent investment scheme claiming high steady returns, by actually paying early investors with later investors’ money and claiming it as the ‘return’. This swindle earned its name from an Italian man named Charles Ponzi who first invented it and took millions away from American people in the early 1920s. He promised his clients a 50 percent return rate within 45 days or 100 percent profit within 90 days by buying discounted postal reply coupons in other countries and redeeming them at face value in the United States. This scheme ran successfully for over one year but when it was finally investigated it collapsed.

Bernard Madoff’s financial fraud has been called the world’s largest and longest-lasting Ponzi scheme. Basically, he adopted the same strategy as Charles Ponzi did. As a former non-executive chairman of the NASDAQ stock market and the founder of the Wall Street firm Bernard Madoff Investment Securities, he sketched a promising outcome, guaranteeing a steady considerable rate of return. However, there was neither clear disclosure of where the money came from and went, nor was there any access for Madoff’s clients to check up their own accounts.

In Madoff’s swindle, victims ranged from assets management firms to commercial banks, fund insurers to financial services companies, and charity organisations to
individual investors. They extended from the United States to Spain, Austria, Britain, France, the Netherlands, Switzerland, Japan, Italy and Sweden (WSJ, 2009). The fact that they were fooled does not necessarily mean the swindle was comprehensive and perfectly designed. In fact, Madoff's fraud scheme ‘was poorly designed and contained so many glaring errors’ (Markopolos, 2010, p. 37) that a financial professional would not see how it could be functional, much less profitable. In Harry Markopolos’ book No One Would Listen: A true financial thriller (2010), the author recalled how he first discovered something wrong with Madoff’s investment mechanism (2010, p. 38):

At the bottom of the page a chart of his return stream rose steadily at a 45-degree angle, which simply doesn’t exist in finance. Within five minutes I told ....... 'There’s no way this is real. This is bogus.

4. BERNA RD MADOFF’S FRAUD UNDER THE LENS OF THE FRAUD TRIANGLE

In order to prevent a possible fraud, it is crucial to analyse circumstances in which the perpetrators would be likely to violate ethical standards and commit fraud. The following section discusses Bernard Madoff’s fraud case using the Fraud Triangle as the lens to explain fraudsters’ behaviours.

4.1 Theoretical Framework: Fraud Triangle

The Fraud Triangle framework helps us to understand the background of this particular fraud scheme. This framework was developed by the famed American criminologist Donald R. Cressey in the 1950s (Coenen, 2009) in criminology report named, “Other People’s Money: A Study in the Social Psychology of Embezzlement”. This framework was widely used by regulators, professionals and academics to explain why people commit fraud. In Cressey’s hypothesis, corporate frauds are more likely to occur when a person possesses three key factors of fraud triangle: motivation (pressures/incentives) to commit fraud, opportunities to implement it and rationalisations to excuse the fraud. The presence of all three elements will stimulate people to engage in fraudulent acts in which each element plays an equally important role.
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**Figure 1 ‘The Fraud Triangle’ (Nodon, 2015)**

The first factor of fraud triangle is motivation. It mostly arises due to financial problems such as gambling addiction, accumulated debt, unexpected expenditures or just the lure of greed (Buchholz, 2012). Another possible motivation is performance-based compensation or remuneration plan for top managers, which might lead to incentives to fake positive earnings or upward share price (Day, 2010). Besides the perceived non-sharable financial needs above, there are non-financial motivations of maintaining reputation, gaining popularity or any other method of advancing one’s personal social standing. Day (2010) adds that the motivation is based on personal status and those needs could be determined by either the hunger to achieve or the fear of losing it. Unlike economic incentive, these non-financial motivations are hard to detect and fully explain.

The second element of the fraud triangle is opportunity, which is a perceived chance that fraud could be committed without being caught. Opportunity would explain how the fraudsters utilise their position, power or capability to fulfil their non-shareable needs. In order to deter fraud, it is crucial for a company to prevent perceived opportunities from arising. Fraud opportunity has a positive relationship with poor internal control, especially with reference to the segregation of duties (Dorminey et al., 2010). A good internal control mechanism is expected to build up such procedures, rules and other safeguards that provide reasonable assurance as well as effectively eliminate any possible opportunities that may occur. In addition, opportunity could also result from an ineffective antifraud program, weak ethical culture, collusion or management override.
Interestingly, junior auditors who lack experience and scepticism may give the fraudulent opportunities to fraudsters themselves. The circumstances in which the graduate auditors are left to complete the tasks without their senior partners’ supervision provide great opportunities for clients to commit or hide fraud.

The third element, rationalisation, is established to make an excuse for the fraudulent act. Before committing a crime, the perpetrator always tried to find a reason to justify his or her act as being morally acceptable. Hence, they would view themselves as victims of circumstance rather than fraudsters (Cressey, 1973). For example, a fraudster might rationalise his action by thinking “it is for a good cause”, “I will pay it back later” or “everyone is doing it”. Especially, SAS 99 AU Section 316.85 A.3 recognises that the fraudulent rationalisation is more common to those employees with "behavior indicating displeasure or dissatisfaction with the company or its treatment of the employee". Similar to non-financial motivation, rationalisation may be difficult to detect because it is unobservable and psychologically related. Interestingly, crime could be committed without any rationalisation or excuse. The core elements that make a fraudulent act appear should be limited to motivation and opportunity only.

4.2 Applying Fraud Triangle to Bernard Madoff’s case

Fraud Triangle is a relatively simple and understandable framework to explain the actions of fraudsters. Regarding the first element, Bernard Madoff seemed to build his Ponzi scheme because he was motivated and felt pressure. Bernard Madoff’s incentive was simply a desire to maintain the lucrative lifestyle to which he had become accustomed or just a “lure of greed” (Buchholz, 2012). Besides, Madoff faced the pressure of maintaining the reputation and profit of the firm. Hurt (2009) points out that Madoff was struggling to generate sufficient profits to cover returns for investors that required him to repay early investors with new investors’ money.

With regard to the second element, ‘opportunity’, it seems clear that Madoff took advantage of his position as head of the company, which gave him more chance to commit a crime without being questioned. Madoff had enough management power and authority to design the level of internal control and corporate governance in such an advantageous way for himself. Firstly, it is obvious that the typical segregation of duties
in Madoff’s hedge fund was missing (Fuerman, 2009). Normally, an investment manager should have segregated duties in his capacity as a manager of assets, a broker who executes trades, a fund administrator who calculates the net asset values and a custodian who has custody of assets. However, BMIS’s hedge fund performed all four of these functions without any distinct separation, which led to a very low level of internal control. Secondly, the corporate governance of BMIS had all the key players being the Madoffs with his brother as the chief compliance officer, his nephew as the director of administration, his sons as directors, his niece as the general counsel and rules compliance attorney (Fuerman, 2009). Thirdly, Madoff approved of and insisted on using a solo auditor. The auditing company that Madoff hired was Friehling & Horowitz, as mentioned before, a firm consisting of only three employees and one office, and was extremely small despite the scale and scope of BMIS’s activities.

Another great opportunity that Madoff found was people’s trust in his reputation. Madoff had gained a remarkable reputation by his efforts in the 1970s and 1980s to establish a competitive advantage and increase the influence of NASDAQ, which then became one of the largest stock exchanges in North America (Henriques, 2012). Madoff was appointed a non-executive chairman of NASDAQ and this position brought him considerable respect and trust from both investors and regulators. Besides, the trading arm of BMIS was highly lucrative, which further enhanced the public’s trust in his business. Hurt (2009) calls Madoff’s fraudulent scheme an “Affinity fraud” in which the fraudsters cultivated and gained the trust of others and then took advantage of that trust. Due to the implicit trust gained from the wider community, Madoff had no difficulty in recruiting reputed clients, in terms of both quantity and quality, for his Ponzi scheme without raising any scepticism. Nevertheless, the opportunity given to Madoff may have been created by Madoff’s victims themselves. The greed for more wealth encouraged investors to stimulate Madoff into designing a scheme to exploit such greed (Henriques, 2012). The returns offered by the BMIS fund were extraordinarily higher than those of normal hedge funds, which should have been considered ‘too good to be true’, but no one raised any questions.
Last but not least, the rationalisation element should be taken into account in order to analyse Madoff’s fraudulent acts. Day (2010) deduces that Madoff rationalised his action by assuring that he was doing the right thing for himself and for his family by exploiting his investors. Henriques (2012), however, analyses the inside thoughts of Madoff at a deeper level, in which he always tried to justify his fraud as being morally acceptable according to a startlingly perverse rationalisation. Firstly, Madoff rationalised that “it was their fault for trusting me”. From his point of view, the banks and funds that he tricked should have known that there were some problems with the scheme because they were financial professionals. Secondly, he argued that his victims were rich and none of them would face poverty after losing their investment. In reality, not everyone was trapped by Madoff’s hedge fund and the investors who lost were the players joining the game at the very last second. Thirdly, Madoff tried to justify his fraudulent engagement by persuading himself that the market was rigged anyway so if he had not done that, others would. There is no room for investors to earn profits from the market without bearing any risk of being tricked. As can be seen, it became clear that the existence of Madoff’s fraud was the eventual end result of all the financial incentives, perceived opportunities and defensive rationalisations described above.

5. ROLE OF AUDITORS IN THE MADOFF CASE

Well-known accounting firms such as KPMG, PricewaterhouseCoopers, BDO Seidman and McGladrey & Pullen, have all suggested it was secure to invest huge funds with Madoff and his asset-management firm (Gandel, 2008). However, it seems that KPMG and other auditors of Madoff’s feeder funds did not do enough to make sure that investors’ decisions were correct. Experts indicate what the accounting firms did was only to check the statements that Madoff generated himself (Gandel, 2008). One of the funds operated by Madoff called Rye Select sent a statement to its investors indicating the valuation provided by Madoff would not be reviewed independently (Gandel, 2008). However, it is the responsibility of auditors to plan and conduct the audit with reasonable care and skill as well as a professional attitude where nothing is accepted at face value (Gay & Simnett, 2015). In order to identify opportunities for conducting fraud, auditors are required to have a comprehensive understanding of customers’ business,
be open-minded and know very well about management’s practices and behaviours, and be able to judge the management’s representations (Gay & Simnett, 2015). Moreover, auditors are responsible for providing opinions regarding the financial report’s truth and fairness, and showing care and skill when dealing with audit planning and conducting investigations into fraud problems. Therefore, reasonable expectation would be given for material misstatement detection, which may result in fraud (Apostolou & Crumbley, 2008).

Three obvious red flags emerged in this case. For example, a unique fact for Madoff was that his firm did not ask any of the large auditing firms to assist them. Instead, it used a small-sized accounting firm, Friehling & Horowitz (Gandel, 2008). While Madoff had a good reputation in business, auditors still had the responsibility to provide true and fair opinions. In the process of the audit, the auditor has to be concerned with the risk of any fraud happening that may lead to a material misstatement as a part of the financial report, despite the auditor’s experience with the organisation regarding the management’s honesty and integrity and those who are in charge of governance (Gay & Simnett, 2015). The auditor has to acknowledge the chance of fraud occurring, especially in times of global economic or financial crisis (Apostolou & Crumbley, 2008). The auditor needs to have the experience, training and knowledge to identify risk signs of fraud, or ‘red flags’, and initiate appropriate behaviours (Gay & Simnett, 2015).

The lack of sufficient internal control is another concern regarding this case. The composition of Madoff’s firm determined the absence of duties being segregated. It is suggested that accountants should not be responsible for a capital-management company to audit and identify underlying problems of investments the company is involved in (Gandel, 2008). Internal control is not always reliable and it is possible that a risk will occur unexpectedly. Furthermore, internal control may be not an effective vehicle to avoid fraud, as certain personnel within the business are able to override controls designed to prevent frauds. Though referring to SAS 99, the governance and management bodies of the entity have the major responsibility for prevention and detection of fraud (Gay & Simnett, 2015). The auditor is still required to be open-minded
and have an excellent grasp of management’s practices and conduct (Gay & Simnett, 2015).

Thirdly, clients of Madoff indicated that large accounting companies signed off on statements saying Madoff’s investment mechanism had billions of dollars in assets. It also had an unlikely track record presenting years of always-positive returns (Gandel, 2008).

5.1 The Role and Responsibilities of Friehling & Horowitz, BMIS’s Auditor

As the scheme unravelled, one of the biggest questions the public asked was the responsibilities of auditors for failing to detect Madoff’s fraud. In this section, the role of David Friehling, the sole practitioner who audited Bernard Madoff Investment Securities (BMIS), and his accounting firm, Friehling & Horowitz, is discussed. This discussion will determine whether or not auditors were sceptical enough to detect the fraud.

Auditors and auditing firms in the United States are regulated by the American Institute of Certified Public Accountants (AICPA, 2015) which sets Generally Accepted Auditing Standards (GAAS) applying to audits of privately owned firms, and the Public Company Accounting Oversight Board (PCAOB) which sets out standards for public organisations’ audits (Anandarajan & Kleinman, 2014). In GAAS, SAS 99 “Consideration of Fraud in a Financial Statement Audit” defines the concept of fraud in auditing, the duties of external auditors, and also provides guidelines in dealing with possible frauds during an audit. SAS 99 clarifies that it is management’s responsibility to manage fraud. Auditors, however, are required to express an opinion on the financial statements with reasonable assurance, which means they must conduct appropriate procedures in order to be reasonably sure that the financial statements are free from material misstatements caused by errors or fraudulent activities. This goal can be obtained by exercising professional scepticism (Glover & Prawitt, 2014), discussing with team members any suspected fraud and making enquiries of management and other staff members of the entities regarding risk of fraud (Landes & Gibson, 2003). The standard also requires auditors to, in the case of fraud detection, communicate with staff charged with governance and with regulatory authorities.
In Madoff’s fraudulent scheme, BMIS’ auditor, Friehling & Horowitz, an accounting firm consisted of only three employees, of which one, David G. Friehling, was a certified auditor. Friehling & Horowitz failed any and all responsibilities required in SAS 99 because the firm “sold its license to Madoff for more than 17 years”, as commented by James Clarkson, SEC New York Regional Office’s acting director (Hamilton, 2009). Friehling, as the sole auditor of the firm, later admitted that he did not perform any audit, not even basic procedures such as verifying the existence of assets which BMIS claimed to possess (Abkowitz, 2008). What Friehling did was simply to stamp documents falsely declaring that he had audited BMIS’s financial statements pursuant to GAAS; that these financial statements were aligned with the US GAAP; and the internal controls of BMIS were adequate. All were done with a full understanding that BMIS’s investors would rely on these documents in their decision-making (Hamilton, 2009). Besides not carrying out the appropriate audit duties, Friehling also violated an AICPA fundamental code of professional conduct: conflict of interest. AICPA forbids accountants to audit broker dealers with whom they are investing (American Institute of Certified Public Accountants, 2015). However, Friehling (disguised under his wife’s account) and his family members invested more than $14 million into BMIS. From the year 2000 onward, they withdrew at least $5.5 million. As Efrati and Lucchetti (2009) commented, it was an undeniable and “blatant” violation of ethics. All in all, it can be concluded that not only did Friehling fail to act properly in his role as auditor, he also failed to meet the ethical standards of his profession.

The failure to conduct a satisfactory audit posed another question regarding the roles of regulation bodies in managing auditor quality. In fact, AICPA had an ‘approved practice-monitoring program’ which required mandatory peer review of auditors of member firms to be conducted once every three years. This program set out to ensure the capability of its members to perform proper and quality audits. Friehling & Horowitz was a registered member of AICPA. However, it had not gone through any peer review since 1993 because the firm had ‘reported every year, in writing’, that it did not engage in any audit activities (Abkowitz, 2008). AICPA later concluded that it was an ethical issue and released an ‘expulsion from membership for failure to cooperate’ (Roybank, 2009).
Another authority overseeing audit quality was the PCAOB, created under the Sarbanes-Oxley Act 2002 (SOX) to “protect the interest of investors”. SOX required auditors who audited non-public broker dealers, of which BMIS was one, to be registered and inspected by PCAOB. However, the deadline for such registration was postponed several times. Thus, Friehling & Horowitz did not have to register and was never inspected by PCAOB (Roybank, 2009).

5.2 The Role & Responsibilities of Feeder Funds’ External Auditors
Fuerman (2009) and several other researchers went further in questioning the responsibilities, if any, of accountants who audited the feeder funds which invested in Madoff’s Ponzi scheme. There was evidence that some people in the management of some feeder funds were aware that BMIS was audited by a single professional qualified employee firm. For example, McKenzie of Fairfield Greenwich Group, a firm which put most of its money into BMIS, in his email sent out in 2015 stated that “it appears Friehling is the only one employee” (Anwar v. Fairfield Greenwich Ltd, 2013). No sufficient attention was paid to such notice at that time. However, based on this evidence, an assumption could be made that some of the external auditors who audited these firms might have noticed this fact, that BMIS was audited by a single professional qualified employee firm. No conclusion could ever be made regarding this question due to the lack of proper evidence. An opinion uttered by the executive director of the Centre for Audit Quality declined any responsibility of auditors in a capital management firm audit to investigate the “underlying investment of the firms it invests in”, as “the auditor is not in a position to test the existence of the underlying securities” (Gandel, 2008). Although it is true that there was no particular requirement made by regulators enforcing such an investigation, the question of whether these auditors should be responsible is still being debated.

6. CONCLUSION
According to the Fraud Triangle concept, there were reasonable opportunities, motivation/pressure and rationalisation behind Madoff’s behaviour:

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\text{Trusted persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are}
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able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property (Cressey, 1973, p. 30).

The auditors need to make sure that management has conducted risk assessments tests. While management is responsible for conducting risk assessment, auditors need to oversee the process. Auditors are responsible for reviewing management's risk assessment and ensuring that it remains an ongoing effort. When dealing with financial reports, the auditor must be sceptical about the internal control system and specific risks of the business which could lead to material misstatement of opportunities for fraud. Though it is necessary to determine the materiality, the auditor needs to show care in detecting fraud regardless of its materiality. According to the Corporation Act and Crime Act, the auditor has a duty to report fraud. If any suspicious situation arises the auditor needs to inform the appropriate level of management.

Madoff's scandal was not accidental but it was surprising for the educators, regulators, monitoring authorities and community in general to know how long it took to discover the fact. The main lesson to be learned by this event is that auditors' due diligence means more than just dropping by for a visit or relying on the opinions of others. It is a methodology that encompasses all aspects of an investment management organisation, including investment policy, trading patterns and verification of investment returns. While there is no official handbook or checklist, a skilled due diligence audit team should have the experience and know-how to complete the process.

References


Bernard Madoff’s Ponzi Scheme: Allegations of improper influence, interactions between Madoff and the SEC, and the effect of Madoff’s stature and reputation on SEC examinations and investigations. The OIG Investigation Found No Evidence of Improper Influence by Senior SEC Officials Based upon Their Relationships with Madoff. The OIG Found that Madoff Participated in SEC Panels and Events and Communicated with SEC Chairmen, and that SEC Officials Participated in Conferences Arranged by Shana Madoff. Key Words: Fraud Triangle, Role of Auditors, Madoff’s Ponzi Scheme.

1. INTRODUCTION When it was discovered that Bernard Madoff’s asset management unit was, in fact, a massive Ponzi scheme, this news immediately shocked the global economy and became the world largest financial fraud ever committed in history. Madoff had liabilities of approximately US$65 billion and was sentenced to 150 years in prison with restitution of US$17 billion (Frank et al., 2009). In order to understand what triggered and caused Madoff to commit the fraud, this study analyses the case based on the Fraud Triangle Accountancy Business and the Public Interest 2016 122 Bernard Madoff’s Ponzi Scheme: Fraudulent behaviour and the Role of Auditors.

Dr. Mohammad I. Azim (corresponding author), Accounting and Finance, Swinburne University of Technology, Faculty of Business and Enterprise, Hawthorn VIC 3122, AUSTRALIA Tel: +61 3 9214 4500; Fax: +61 3 9819 2117; Email: [email protected] Dr. Saiful Azam, School of Accounting. Auditors may be able to detect fraud at an early stage by becoming sceptical when performing their duties. Key Words: Fraud Triangle, Role of Auditors, Madoff’s Scandal, Ponzi scheme. The role and responsibility of auditors in preventing and controlling fraud in Madoff’s case is also discussed.