

CRAZY EDDIE (Revisited)

Duane Ponko
Indiana University of Pennsylvania

Germain P. Kline
Indiana University of Pennsylvania

Jerry Joseph
Indiana University of Pennsylvania

ABSTRACT

This paper documents the events surrounding the rise and fall of the “Crazy Eddie” electronics empire and details the circumstances that led to the ultimate conviction of Eddie Antar on fraud and racketeering charges. Based upon court releases and other supporting documents, this paper will identify the significant accounting issues that were violated or ignored, thus resulting in one of the major financial scandals to end the 20th century. These findings will then be compared to the major financial crises that began the 21st century involving several large corporations. The paper will conclude with an analysis of the attempt to regulate accounting practices designed at reducing further occurrences.

INTRODUCTION

When last visited just prior to the end of the century, Crazy Eddie’s electronics retailing empire was on the verge of financial collapse. Shrouded by a cloak of major fraud and deception, Crazy Eddie was identified as one of the major corporate scandals of the 20th century. While lengthy litigation proceedings were attempting to identify and prosecute the principle conspirators in the scandal, the beginning of the 21st century was mired by the exposure of several other corporate scandals: Enron, WorldCom, and Tyco to mention a few of the more high profile cases. This paper will revisit “Crazy Eddie” and document the events leading to its financial downfall. These situations will then be compared to the more recent scandals and conclude with legislative and professional attempts to reduce the likelihood of further occurrences.

REVISITED

Corporate History

Eddie Antar began his electronic empire in 1969 with one small retail outlet that was given to him by his father, Sam M. Antar. In 1984, Eddie took the company public and at its peak had increased to 43 retail outlets with total annual sales exceeding \$350 million. In 1987, the company filed for bankruptcy and the last of the original Eddie stores closed in 1989. This miraculous rise and meteoric fall was the

result of fraudulently raising the value of the stock through falsification of inventory records and manipulation of sales and its ultimate discovery.

The Antar’s family greed was satisfied by skimming cash receipts and liquidating artificially inflated stock. A closer retrospect of the companies operations will reveal how the fraud was perpetrated.

Corporate Operations

Eddie Antar’s corporate philosophy was founded on an aggressive sales approach and a frenzied advertising campaign. His business plan was rather basic yet opportunistic:

1. “Never let a customer out the door without selling him something.” This tactic frequently resulted in face to face negotiations.
2. Emphasize the customer’s need to purchase an extended warranty. Promoted to provide the customer with added confidence in their purchases, it added to the company’s profits since much of the service work was covered by the manufacture’s plan.
3. Purchase inventory in larger quantities to take advantage of price concessions. (Crazy Eddie would buy in volume at large discounts and then illegally sell to other wholesalers at slightly above his cost.)
4. Promise “anything” to get the customer in the store. (This would provide the

opportunity for an aggressive sales force to take over and also create an environment for the infamous (and illegal) “Bait and Switch”.

These strategies created increased sales and presented the opportunity for the first of the Antar family’s greedy activities: skimming cash from the daily receipts. Many of the sales transactions were in cash. The cash was separated into three basic piles:

- Pile 1: Deposited as store receipts,
- Pile 2: Paid employees off the books,
- Pile 3: Deposited by family members into Israeli accounts during their many trips abroad.

It was estimated that this would amount to \$1 for every \$5 reported in company earnings and totaled between 3 and 4 million dollars per year. Once the company went public it was imperative to show strong earnings to sustain an increasing price per share. It was through the liquidation of stock at these inflated prices that the Antars satisfied the second of their greedy intentions: Crazy Eddie was able to accomplish this charade by artificially misstating inventory levels and reporting nonexistent sales.

Inventory

Overstating inventory results in higher assets yielding stronger financial ratios; it reduces cost of goods sold creating higher profit. Crazy Eddie was able to accomplish this shell game by implementing several deceptive practices. The company’s warehouse manager said Eddie approached him near the end of the fiscal year 1985, and “asked me to make changes to the inventory figures to show more inventory than was being counted. He said he wanted to do this to make the company look better and I never questioned that.” He increased total inventory by \$2 million in 1985 and \$6 million in 1986. When the auditors came to make their counts, he climbed onto the product stacks himself, and called the numbers down to the person below. If the auditor insisted on climbing up, the warehouse manager held the auditor’s notebook and marked the counts himself. He used a range of inflationary strategies: counting empty boxes as merchandise, listing cheap merchandise at premium prices, building tall “dummy” columns at the edge of a large shelf and claiming the containers were stacked three or four deep when the rear area was in fact empty. When Sam E., a CPA and former employee of the company’s external audit firm, was appointed as Chief Financial Officer in 1986, he inherited a \$3 million deficit and was instructed by

Eddie that an additional \$10 million “bump” would be needed for the coming year. The younger and less experienced auditors did not appear to be a match for the devious and deceptive tactics employed by Crazy Eddie’s top management. The auditors were also placed in the awkward situation of auditing previous members of their firm.

Sales

Eddie boasted of the fact that Crazy Eddie had never recorded a loss, so when sales growth had slowed it was necessary to devise a scheme to artificially inflate sales receipts. The sales growth was achieved by an innovative concept devised by Sam Antar which was referred to as “The Panama Pump”. That is the name prosecutors used to describe Sam’s plan for manipulating the family’s international banking connections. “I was surprised, really, that nobody had thought of doing it before”, Sammy admits. “We had been gradually moving the money we skimmed into Israeli banks. So then I learned how to bring the money back using what’s called a double secrecy jurisdiction transaction. Panama today has one of the strictest bank secrecy laws in the world. The country has no currency of its own. Panama used U.S. currency, and Israelis own some of the biggest banks in Panama. Since the banks are in the same network, you can request that both the withdrawal and the new deposit be kept secret. So, we opened accounts in Panama using false names. Using the secrecy laws we transferred a million and a half-dollars from Bank Leumi Israel to the Leumi bank in Panama. Then we had the alias-owned Panama account write drafts payable to Crazy Eddie. Now we had successfully brought the money into the company. The worst that happens is we have to pay some taxes.” Thanks to these funds from Israel, Crazy Eddie, showed a growth rate of 13-14% instead of 4%. The company stock shot to \$22/share. This was really a unique situation in business: Skimmed sales, hidden from the IRS, were later “un-skimmed” to increase sales.

Accounting Issues

The first and most basic question asked whenever a major fraud case has been exposed is “How could this have gone undetected?” In the case of Crazy Eddie, the close relationship between the company accountants and the external auditors brought into question the issue of “independence.” Sammy, the Crazy Eddie CEO, received his required CPA experience with Penn and Hardwood: a local firm who handled the audit function. When the company switched to the accounting firm of Main Hurdman prior to going public, they were paying substantial

fees for a service contract while paying a lesser amount in audit fees. A common problem and concern is when you traditionally have young and inexperienced auditors confronting oftentimes a more experienced and savvy management team. Table 1 summarizes several of the audit failures identified in the Crazy Eddie fraud:

Table 1
Recap of Auditor's Failures

- For one year Main Hurdman's audit fee was \$85,000. At the same time, Main was charging millions of dollars to Crazy Eddie for computerizing Eddie's inventory system. (Eddie later dropped this computerized system in favor of a manual system because it was easier to manipulate the inventory.)
- Many of Eddie's in-house accountants were recruited from the auditing firm.
- When the auditors uncovered an incriminating piece of evidence relating to inventory overstatements, they showed it to Eddie. He claimed that an employee was apparently trying to cause trouble because you would have to be very dumb to "cheat" like that.
- Auditors left their work papers open in an obvious place. Sam E. then reviewed their working papers to monitor their work.
- Suppliers as large as Sony colluded with Eddie to present false information to the auditors.
- Auditors failed to note and/or investigate large "rounded" dollar "sales" such as \$116,000 draft in a retail store. (This is how the previously skimmed sales were reported.)
- Auditors failed to note and/or investigate bogus debit memos of over \$20 million.
- Eddie was able to prepare for selected inventory audit sites.
- Auditors used Eddie's warehouse personnel to help them "count".
- Auditors failed to note and/or investigate that competitors (wholesalers) sales were put into retail stores for "same store" sales. (A key ratio that financial analysts follow for retailers is the measure of growth in existing stores versus growth resulting from adding new retail outlets.)
- Trusted all vendors and wholesalers to be "unrelated" parties.

A brief summary of some of the litigation findings against the principle players in the Crazy Eddie fraud and racketeering cases is described in Table 2.

Table 2
Litigations

Eddie Antar: a.k.a. Crazy Eddie. Pleaded guilty to one count of insider trading in 1996 and was sentenced to nearly seven years in prison. He has since been released and has returned about \$63 million to the court for distribution to investors.¹

Sam M. Antar: father. Found guilty of insider trading in 1998 and was liable to the Commission for disgorgement and prejudgment interest totaling \$57,510,642.²

Rose Antar: mother. Principal partner in R.A.S. Partnership, L.P., a New Jersey limited partnership, and principal partner in S.T. Partnership, L.P., a New Jersey limited partnership, recipient of fraudulent transfer from her spouse. The Court held that the Commission was entitled to summary judgment with respect to transfers.²

Sam E. Antar: cousin/CEO/CPA. Cooperated with prosecutors and the FBI. Sentenced to 6 months in jail and required to complete 1200 hours of community service.

Allan Antar: brother/cash employee. Found guilty of insider trading and was found liable for disgorgement and prejudgment interest totaling \$11,911,045.³

Benjamin Kuszer: bother-in-law. Found guilty of insider trading and was found liable for disgorgement and prejudgment interest totaling \$3,306,240.³

A New Era

The beginning of a new century also brought with it a new era of major fraud cases. It seems that each one was bigger than the last. To site a few: Enron, WorldCom, TYCO, Rite Aid, Adelphia. Although each presented their own unique deceptive practices and techniques, the underlying constant was corporate greed. The second of the basic questions asked when fraud is exposed is: "How can these situations be prevented?" Unlike the previous question which wanted to know how these practices could have gone undetected, foresight is always less certain than hindsight. Once a fraud has been documented, it is easy to find weaknesses within the system and attempt to establish new practices and procedures to eliminate a recurrence. The temptation

and tendency is to regulate what is known since we are not clairvoyant and cannot with complete assurance anticipate what is unknown. The most significant piece of legislation triggered by these scandals has been the Sarbanes-Oxley Act of 2002. Although some of the techniques might differ, the common denominator for each of the corporate scandals was the result of greed and deception initiated by top executives.

A summary of the key provisions contained in the "Act" are presented in Table 3.

Table 3

Title I	-	Public Company Accounting Oversight Board
Title II	-	Auditor Independence
Title III	-	Corporate Responsibility
Title IV	-	Enhanced Financial Disclosures
Title VII	-	Studies and Reports
Title VIII	-	Corporate Fraud and Criminal Accountability Act of 2002
Title IX	-	White-Collar Crime Penalty Enhancements
Title XI	-	Corporate Fraud and Accountability

Note: This information was taken from H.R. 17463.

A primary objective of this type of legislation is to restore confidence in the use of audited financial statements, and while enactment and implementation can attempt to reduce the level of fraud by creating greater obstacles to overcome; it can not eliminate entirely the potential for future cases. To use an analogy: The creation of a Department of Homeland Security and the expenditure of millions of dollars to consolidate several agencies and to develop heightened policies and procedures has given the public an increased sense of security. However, I am confident that no one believes that the threat of future terrorists' acts will be eliminated. Just as you cannot legislate political and philosophical differences, you cannot legislate moral and ethical corporate actions. At best, it serves as a deterrent.

ENDNOTES

¹The *Miami Herald*, posted Tuesday, August 6, 2002.

²Securities and Exchange Commission: Litigation Release No. 16817/December 4, 2000.

³Securities and Exchange Commission: Litigation Release No. 16544/May 9, 2000.

Note: This information is intended to provide a brief summary of some of this litigation findings involving several of the principals in the Crazy Eddie fraud and is not intended to be a complete and final documentation of all the criminal and civil proceedings.