

RED FLAGS IN FINANCIAL STATEMENTS



10 warning signs, read the way an auditor would. Each one drawn from a real case file. By Off Book Files · @offbookfiles

EARNINGS SMOOTHER THAN THE BUSINESS

01

Real businesses are lumpy; results that land on target every quarter in a volatile industry are a question, not a comfort.

Look for: Quarter-on-quarter earnings vs. cash flow and vs. peers; repeated last-minute deals that hit forecasts exactly.

Case: Enron: the DOJ described a scheme to make Enron look as if it was growing at a healthy, predictable rate matching analysts' expectations.

Source: DOJ, Lay & Skilling verdict, 25 May 2006

PROFIT TODAY, CASH SOMEDAY

02

Valuing long contracts from a model can book profit years before any cash arrives.

Look for: Large unrealised or mark-to-market gains; operating cash flow lagging reported profit; key valuation assumptions not disclosed.

Case: Enron used mark-to-market accounting on long, unusual energy contracts where no real market price existed.

Source: Off Book Files Enron case file

INSIDERS ON BOTH SIDES OF THE DEAL

03

Related-party deals can move risk and profit away from shareholders without a true arm's-length price.

Look for: Related-party footnotes; entities run or owned by executives; deals with off-balance-sheet vehicles.

Case: Enron: CFO Andrew Fastow ran the LJM partnerships that dealt with Enron. He pleaded guilty to two conspiracy counts in 2004.

Source: DOJ press release, 14 Jan 2004

A "SALE" WITH A PROMISE TO BUY IT BACK

04

If the seller guarantees the buyer an exit, the risk never moved, so it is a loan dressed as a sale.

Look for: Sales near quarter-end; side letters, guarantees or repurchase commitments; buyers who are banks or friends.

Case: Enron's 1999 Nigerian barge deal: the SEC alleged the bank was assured it would be taken out at a profit. (Related banker convictions were largely vacated on appeal in 2006.)

Source: SEC v. Fastow complaint (allegations); US v. Brown (5th Cir. 2006)

DEBT THAT SHRINKS AT QUARTER-END

05

Borrowing that disappears just before reporting dates and returns days later flatters leverage.

Look for: Average vs. period-end borrowings; repo or financing transactions accounted for as sales.

Case: Lehman Brothers: the bankruptcy examiner found Repo 105 temporarily removed up to \$50.38bn from the balance sheet in Q2 2008.

Source: Lehman Examiner's Report (Valukas), 2010

CASH THAT CAN'T BE CONFIRMED

06

Cash is the easiest asset to verify, so cash that can only be seen through third parties is a warning.

Look for: Large balances held via trustees or partners; no direct bank confirmation; cash growing while borrowing also grows.

Case: Wirecard said in June 2020 that €1.9bn of balances on trustee accounts most likely did not exist, then filed for insolvency.

Source: Wirecard AG ad hoc statements, 22 & 25 June 2020

BANK STATEMENTS SUPPLIED BY THE COMPANY

07

A statement handed over by management is management's document; auditors confirm cash bank-to-auditor.

Look for: Copies or PDFs instead of direct confirmations; inconsistent formatting; balances that never match the bank.

Case: 777 Partners: prosecutors said founder Joshua Wander falsified bank statements. He pleaded guilty to wire and securities fraud on 15 Oct 2026.

Source: DOJ USAO-SDNY press release, 15 Oct 2026

THE SAME ASSET PLEDGED TWICE

08

Collateral counted twice protects nobody; lenders each think they hold it.

Look for: Lien searches, lender confirmations, collateral schedules that don't reconcile across facilities.

Case: 777 Partners: prosecutors said Wander double-pledged assets and pledged fictitious assets.

Source: DOJ USAO-SDNY press release, 15 Oct 2026

NO BASIC RECORDS OR CONTROLS

09

If a company can't list its own bank accounts, nobody can say what it owns.

Look for: Missing account lists, no reconciliations, payment approvals outside any system.

Case: FTX: new CEO John J. Ray III told the court there was no accurate list of bank accounts and that spending was approved by emoji.

Source: Ray declaration, Doc 24, Case 22-11068 (D. Del., 17 Nov 2022)

RELATED PARTIES CONFIRMING THEIR OWN BALANCES

10

Evidence from someone who controls both sides isn't independent evidence.

Look for: Large related-party receivables; confirmations signed by the same insiders; balances never settled in cash.

Case: FTX: the bankruptcy examiner reported related-party balances, including a \$1.2bn Alameda receivable, were confirmed by asking Bankman-Fried.

Source: Examiner Robert J. Cleary report, Doc 15545 (D. Del., 23 May 2024)

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