

The Leslie Fay Companies

Paul Polishan graduated with an accounting degree in 1969 and immediately accepted an entry-level position in the accounting department of The Leslie Fay Companies, a women's apparel manufacturer based in New York City. Fred Pomerantz, Leslie Fay's founder, personally hired Polishan. Company insiders recall that Pomerantz saw in the young accounting graduate many of the same traits that he possessed. Both men were ambitious, hard driving, and impetuous by nature.

After joining Leslie Fay, Polishan quickly struck up a relationship with John Pomerantz, the son of the company's founder. John had joined the company in 1960 after earning an economics degree from the Wharton School at the University of Pennsylvania. In 1972, the younger Pomerantz became Leslie Fay's president and assumed responsibility for the company's day-to-day operations. Over the next few years, Polishan would become one of John Pomerantz's most trusted allies within the company. Polishan quickly rose through the ranks of Leslie Fay, eventually becoming the company's Chief Financial Officer (CFO) and Senior Vice President of Finance.

Leslie Fay's corporate headquarters were located in the heart of Manhattan's bustling garment district. However, the company's accounting offices were 100 miles to the northwest in Wilkes-Barre, Pennsylvania. During Polishan's tenure as Leslie Fay's top accounting and finance officer, the Wilkes-Barre location was tagged with the nickname "Poliworld." The strict and autocratic Polishan ruled the Wilkes-Barre site with an iron fist. When closing the books at the end of an accounting period, Polishan often required his subordinates to put in 16-hour shifts and to work through the weekend. Arriving two minutes late for work exposed Poliworld inhabitants to a scathing reprimand from the CFO. To make certain that his employees understood what he expected of them, Polishan posted a list of rules within the Wilkes-Barre offices that documented their rights and privileges in minute detail. For example, they had the right to place one, and only one, family photo on their desks. Even Leslie Fay personnel in the company's Manhattan headquarters had to cope with Polishan's domineering manner. When senior managers in the headquarters office requested financial information from Wilkes-Barre, Polishan often sent them a note demanding to know why they needed the information.

Polishan's top lieutenant at the Wilkes-Barre site was the company controller, Donald Kenia. On Polishan's frequent trips to Manhattan, Kenia assumed control of the accounting offices. Unlike his boss, Kenia was a soft-spoken individual who apparently enjoyed following orders much more than giving them. Because of Kenia's meek personality, friends and co-workers were stunned in early February 1993 when he took full responsibility for a large accounting fraud revealed to the press by John Pomerantz. Investigators subsequently determined that Leslie Fay's earnings had been overstated by approximately \$30 million from 1990 through 1992.

Following the public disclosure of the large fraud, John Pomerantz repeatedly and adamantly insisted that he and the other top executives of Leslie Fay, including Paul Polishan, had been unaware of the massive accounting irregularities perpetrated by Kenia. Nevertheless, many parties inside and outside the company expressed doubts regarding Pomerantz's indignant denials. Kenia was not a major stockholder and did not have an incentive-based compensation contract tied to the company's earnings.

meaning that he had not benefited directly from the grossly inflated earnings figures he had manufactured. On the other hand, Pomerantz, Polishan, and several other Leslie Fay executives held large blocks of the company's stock and had received substantial year-end bonuses, in some cases bonuses larger than their annual salaries, as a result of Kenia's alleged scam. Even after Kenia pleaded guilty to fraud charges, many third parties remained unconvinced that he had directed the fraud. When asked by a reporter to comment on Kenia's confession, a Leslie Fay employee and close friend of Kenia indicated that he was a "straight arrow, a real decent guy" and then went on to observe that, "something doesn't add up here."¹

Lipstick-Red Rolls Royces and the Orient Express

Similar to many of his peers, Fred Pomerantz served his country during World War II. But instead of storming the beaches of Normandy or pursuing Rommel across North Africa, Pomerantz served his country by making uniforms, uniforms for the Women's Army Corps. Following the war, Pomerantz decided to make use of the skills he had acquired in the military by creating a company to manufacture women's dresses. He named the company after his daughter, Leslie Fay. His former subordinates and colleagues in the industry recall that Pomerantz was a "character." Over the years, he reportedly developed a strong interest in gambling, enjoyed throwing extravagant parties, and reveled in shocking new friends and business associates by pulling from his shirt to reveal knife scars he had collected in encounters with ruffians in some of New York's tougher neighborhoods. Adding to Pomerantz's legend within the top rung of New York's high society was his lipstick-red Rolls Royce that he used to cruise up and down Manhattan's crowded streets.

Pomerantz's penchant for adventure and revelry did not prevent him from quickly establishing his company as a key player in the volatile and intensely competitive women's apparel industry. From the beginning, Pomerantz focused Leslie Fay on one key segment of that industry. He and his designers developed moderately priced and stylishly conservative dresses for women ages 30 through 55. Leslie Fay's principal customers were the large department store chains that flourished in major metropolitan areas in the decades following World War II. By the late 1980s, Leslie Fay was the largest supplier of women's dresses to department stores. At the time, Leslie Fay's principal competitors included Donna Karan, Oscar de la Renta, Nichole Miller, Jones New York, and Albert Nipon. But, in the minds of most industry observers, Liz Claiborne, an upstart company that had been founded in 1976 by an unknown designer and her husband, easily ranked as Leslie Fay's closest and fiercest rival. Liz Claiborne was the only publicly owned women's apparel manufacturer in the late 1980s that had larger annual sales than Leslie Fay.

Fred Pomerantz took his company public in 1952. In the early 1980s, the company went private for a period of several years via a leveraged buyout orchestrated by John Pomerantz, who became the company's chief executive officer (CEO) and chairman of the board following his father's death in 1982. The younger Pomerantz pocketed \$40 million and a large bundle of Leslie Fay stock when the firm reemerged as a public company in 1986. Like his father before him, John Pomerantz believed that the top executive of a company involved in the world of fashion should exhibit a certain amount of panache. As a result, the popular and outgoing businessman invested in several Broadway shows and became a mainstay on Manhattan's celebrity circuit. The windfall that Pomerantz realized in the early 1980s allowed him to buy an elegant,

1. S. Strom, "Accounting Scandal at Leslie Fay," *The New York Times*, 2 February 1993, D1.

Mediterranean style estate in Palm Beach, Florida, where he often consorted during the winter months with New York City's rich and famous. To reward his company's best clients, he once rented the legendary Orient Express for an extended and festive railway jaunt across northern Europe and Asia.

Despite Leslie Fay's size and prominence in the apparel industry, John Pomerantz continued operating the company much like his father had for decades. Unlike his competitors, Pomerantz shunned extensive market testing to gauge women's changing tastes in clothes. Instead, he relied on his and his designers' intuition in developing each season's new offerings. Pomerantz was also slow to integrate computers into his company's key internal functions. Long after most women apparel manufacturers had developed computer linkages to monitor daily sales of their products at major customer outlets, Leslie Fay officials continued to track the progress of their sales by telephoning large customers on a weekly basis. Pomerantz's insistence on doing business the "old-fashioned way" also meant that the company's Wilkes-Barre location was slow to take advantage of the speed and efficiency of computerized data processing.

Management's aversion to modern business practices and the intense competition within the women's apparel industry did not prevent Leslie Fay from prospering after John Pomerantz succeeded his father. Thanks to the younger Pomerantz's business skills, Leslie Fay's annual revenues and earnings grew robustly under his leadership.

Fashion Becomes Unfashionable

By the late 1980s, a disturbing trend that had been developing within the women's apparel industry for several years became even more evident. During that decade, fashion gradually became unfashionable. The so-called "casualization" of America meant that millions of consumers began balking at the new designs marketed by apparel manufacturers, opting instead for denims, t-shirts, and other more comfortable attire, including well-worn, if not tattered, garments that they had purchased years earlier. Initially, this trend had a much more pronounced impact on the buying habits of younger women. But, gradually, even women in the 30-55-year-old age bracket, the consumers targeted by Leslie Fay, decided that casual was the way to go.

Making matters worse for Leslie Fay was that the growing preference for casual clothing had the most dramatic impact on women's dress sales. Since the company's inception, Leslie Fay had concentrated its product offerings on dresses, even after pants suits became widely recognized as suitable and stylish for even "mature" women during the 1970s. In the early 1970s, annual dress sales began gradually declining. Most corporate executives in the women's apparel industry believed this trend would eventually reverse. However, the preference for more casual apparel that developed during the 1980s resulted in this trend continuing throughout the end of the century.

The recession of the late 1980s and early 1990s compounded the problems facing the women's apparel industry. That recession caused many consumers to curtail their discretionary expenditures, including purchases of new clothes. The economy-wide decline in retail spending had far-reaching implications for the nation's major department store chains, Leslie Fay's principal customers. Even as other segments of the economy improved, continued weakness in the retail sector cut deeply into the sales and earnings of department stores. Eventually, several large chains were forced to merge with competitors or to liquidate. In late 1989, Leslie Fay incurred a substantial loss when it wrote off a receivable from Allied/Federated Department Stores after that large retailer filed for bankruptcy. Many of the department store chains that survived wrangled financial concessions from their suppliers. These concessions included longer payment terms, more lax return policies, and increased financial assistance to develop and maintain in-store displays, kiosks, and apparel boutiques.

The structural and economic changes affecting the women's apparel industry during the late 1980s and early 1990s had a major impact on most of its leading companies. Even Liz Claiborne, whose revenues had zoomed from \$47 million in 1979 to more than \$1 billion by 1987, faced slowing sales from its major product lines and was eventually forced to take large inventory write-downs. Occasionally, industry publications reported modest quarterly sales increases. But the companies that benefited the most from those increases were not the leading apparel manufacturers but rather firms such as Clothestime that marketed their wares to discount merchandisers.

Despite the trauma being experienced by its key competitors, Leslie Fay reported impressive sales and earnings throughout the late 1980s and early 1990s. Leslie Fay's typical quarterly earnings release during that timeframe indicated that the company had posted record earnings and sales for the just-completed period. For example, in October 1991, John Pomerantz announced that Leslie Fay had achieved record earnings for the third quarter of the year despite the "continued sluggishness in retail sales and consumer spending."² Exhibit 1 presents Leslie Fay's consolidated balance sheets and income statements for 1987 through 1991. For comparison purposes, Exhibit 2 presents norms for key financial ratios within the women's apparel industry in 1991. These benchmark ratios are composite amounts derived from data reported by several investment services that regularly publish financial ratios and other measures for all major industries.

Even as several of Leslie Fay's competitors questioned how the company was able to sustain strong sales and earnings in the face of the stubborn recession gripping the retail sector, the gregarious John Pomerantz remained upbeat to the business press regarding his company's future prospects. Privately, though, Pomerantz was worried. Pomerantz realized that retailers were increasingly critical of Leslie Fay's product line. "Old-fashioned," "matronly," "drab," and "overpriced" were adjectives that the company's sales reps routinely heard as they made their sales calls. To keep his major customers happy, Pomerantz had to approve significant markdowns in Leslie Fay's wholesale prices and grant those customers large rebates when they found themselves "stuck with excess quantities of the company's products. To keep investors happy, Pomerantz lobbied financial analysts tracking Leslie Fay's stock. One analyst reported that an "irate" Pomerantz called her in 1992 and chastised her for issuing an earnings forecast for Leslie Fay that was too "pessimistic."³

"Houston, We Have A Problem"

On Friday morning, January 29, 1993, Paul Polishan called John Pomerantz who was on a business trip in Canada. Polishan told Pomerantz that, "We got a problem . . . maybe a little more than just a problem."⁴ Polishan then informed his boss of the enormous accounting hoax that Donald Kenia had secretly carried out over the past several years. According to Polishan, Kenia had admitted to masterminding the fraud, although some of his subordinates had helped him implement and conceal the various scams. Pomerantz's first reaction to the startling news? Disbelief. "I thought it was a joke."⁵

2. *Business Wire*, "Leslie Fay Announces Record Earnings," 17 October 1991.

3. T. Agins, "Dressmaker Leslie Fay Is an Old-Style Firm That's in a Modern Fix," *The Wall Street Journal*, 23 February 1993, A8.

4. Strom, "Accounting Scandal at Leslie Fay."

5. T. Agins, "Leslie Fay Says Irregularities in Books Could Wipe Out '92 Profit; Stock Skids," *The Wall Street Journal*, 2 February 1993, A5.

EXHIBIT 1
THE LESLIE FAY
COMPANIES
1987-1991
BALANCE SHEETS

The Leslie Fay Companies Consolidated Balance Sheets 1987-1991 (in millions)					
	1991	1990	1989	1988	1987
ASSETS					
Current Assets:					
Cash	\$ 4.7	\$ 4.7	\$ 5.5	\$ 5.5	\$ 4.1
Receivables (net)	118.9	139.5	117.3	109.9	82.9
Inventories	126.8	147.9	121.1	107.0	83.0
Prepaid Expenses & Other Current Assets	19.7	22.5	19.5	16.4	15.9
Total Current Assets	270.1	314.6	263.4	238.8	185.9
Property, Plant, and Equipment	39.2	30.0	27.2	25.9	24.1
Goodwill	81.3	88.1	91.2	94.1	90.3
Deferred Charges and Other Assets	5.2	6.2	5.5	4.2	5.1
Total Assets	<u>\$395.8</u>	<u>\$438.9</u>	<u>\$387.3</u>	<u>\$363.0</u>	<u>\$305.4</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Notes Payable	\$ 35.0	\$ 48.0	\$ 23.0	\$ 29.0	\$ 15.5
Current Maturities of Long-term Debt	.3	.3	.3	.3	1.4
Accounts Payable	31.9	43.3	38.6	45.6	31.6
Accrued Interest Payable	3.0	3.8	4.1	3.9	3.7
Accrued Compensation	16.9	14.9	19.5	16.6	10.6
Accrued Expenses & Other	4.3	6.4	5.8	7.2	7.4
Income Taxes Payable	1.4	2.3	4.6	6.1	1.8
Total Current Liabilities	92.8	119.0	95.9	108.7	72.0
Long-term Debt	84.4	129.7	129.0	116.3	116.6
Deferred Credits & Other Noncurrent Liabilities	2.8	2.6	2.7	4.2	4.9
Stockholders' Equity:					
Common Stock	20.0	20.0	20.0	20.0	20.0
Capital in Excess of Par Value	82.2	82.2	82.1	82.2	82.2
Retained Earnings	156.9	127.6	98.5	72.8	50.5
Other	(34.3)	(31.5)	(31.9)	(32.0)	(31.7)
Treasury Stock	(9.0)	(10.7)	(9.0)	(9.1)	(9.1)
Total Stockholders' Equity	215.8	187.6	159.7	133.8	111.9
Total Liabilities and Stockholders' Equity	<u>\$395.8</u>	<u>\$438.9</u>	<u>\$387.3</u>	<u>\$363.0</u>	<u>\$305.4</u>

(continued)

When revealing the fraud to the press the following Monday, Pomerantz denied having any clue as to what might have motivated Kenia to misrepresent Leslie Fay's financial data. Pomerantz also denied that he and the other top executives of Leslie Fay had suspected Kenia of any wrongdoing. He was particularly strident in defending his close friend Paul Polishan, who had supervised Kenia and who was directly responsible for the integrity of Leslie Fay's accounting records. Pomerantz firmly told a reporter that Polishan "didn't know anything about this."⁶

6. *Ibid.*

**EXHIBIT 1—
continued**

**THE LESLIE FAY
COMPANIES
1987-1991 INCOME
STATEMENTS**

**The Leslie Fay Companies
Consolidated Income Statements 1987-1991
(in millions)**

	<u>1991</u>	<u>1990</u>	<u>1989</u>	<u>1988</u>	<u>1987</u>
Net Sales	\$836.6	\$858.8	\$786.3	\$682.7	\$582.0
Cost of Sales	<u>585.1</u>	<u>589.4</u>	<u>536.8</u>	<u>466.3</u>	<u>403.1</u>
Gross Profit	251.5	269.4	249.5	216.4	178.9
Operating Expenses:					
Selling, Warehouse, General and Administrative	186.3	199.0	183.8	156.2	132.5
Amortization of Intangibles	<u>2.7</u>	<u>2.9</u>	<u>2.6</u>	<u>3.3</u>	<u>3.8</u>
Total Operating Expenses	<u>189.0</u>	<u>201.9</u>	<u>186.4</u>	<u>159.5</u>	<u>136.3</u>
Operating Income	62.5	67.5	63.1	56.9	42.6
Interest Expense	<u>18.3</u>	<u>18.7</u>	<u>19.3</u>	<u>18.2</u>	<u>16.4</u>
Income Before Non-recurring Charges (Credits)	44.2	48.8	43.8	38.7	26.2
Nonrecurring Charges (Credits)	—	—	—	—	(5.0)
Income Before Taxes on Income	44.2	48.8	43.8	38.7	31.2
Income Taxes	<u>14.8</u>	<u>19.7</u>	<u>18.0</u>	<u>16.4</u>	<u>11.5</u>
Net Income	<u>\$29.4</u>	<u>\$29.1</u>	<u>\$25.8</u>	<u>\$22.3</u>	<u>\$19.7</u>
Net Income per Share	<u>\$ 1.55</u>	<u>\$ 1.53</u>	<u>\$ 1.35</u>	<u>\$ 1.17</u>	<u>\$ 1.03</u>

EXHIBIT 2

**1991 INDUSTRY
NORMS FOR KEY
FINANCIAL RATIOS
FOR THE LESLIE FAY
COMPANIES
INDUSTRY.**

Liquidity:	
Current Ratio	1.8
Quick Ratio	.9
Solvency:	
Debt to Assets	.53
Times Interest Earned	4.2
Long-term Debt to Equity	.14
Activity:	
Inventory Turnover	6.7
Age of Inventory	53.7 days
Accounts Receivable Turnover	8.0
Age of Accounts Receivable	45.5 days
Total Asset Turnover	3.1
Profitability:	
Gross Margin	31.5%
Profit Margin on Sales	2.2%
Return on Total Assets	6.0%
Return on Equity	14.0%

During the following weeks and months, an increasingly hostile business press hounded Pomerantz for more details of the fraud, while critics openly questioned whether he was being totally forthcoming regarding his lack of knowledge of Kenia's accounting scams. Responding to those critics, the beleaguered CEO maintained that rather than being involved in the fraud, he was its principal victim. "Do I hold myself personally responsible? No. In my heart of hearts, I feel that I'm a victim. I know there are other victims. But I'm the biggest victim."⁷ Such protestations did not

7. E. Lesly, "Who Played Dress-up with the Books?" *Business Week*, 15 March 1993, 34.

prevent critics from questioning why Pomerantz had blithely accepted Leslie Fay's impressive operating results while many of the company's competitors were struggling financially.

Shortly after Pomerantz publicly disclosed Kenia's fraud, Leslie Fay's audit committee launched an intensive investigation of its impact on the company's financial statements for the previous several years. The audit committee retained Arthur Andersen & Co. to help complete that study. Pending the outcome of the investigation, Pomerantz reluctantly placed Polishan on temporary paid leave. BDO Seidman had served as Leslie Fay's audit firm since the mid-1970s and issued unqualified opinions each year on the company's financial statements. Following Pomerantz's disclosure of the fraud, BDO Seidman withdrew its audit opinions on the company's 1990 and 1991 financial statements. In the ensuing weeks, Leslie Fay stockholders filed several large lawsuits naming the company's management team and BDO Seidman as defendants. In April 1993, BDO Seidman officials contacted the Securities and Exchange Commission (SEC) and inquired regarding the status of their firm's independence from Leslie Fay given the pending lawsuits. The SEC informed BDO Seidman that its independence was jeopardized by those lawsuits, which prompted BDO Seidman to resign as Leslie Fay's audit firm in early May 1993. Company management immediately appointed Arthur Andersen as Leslie Fay's new auditor.

In September 1993, Leslie Fay's audit committee completed its eight-month investigation of the accounting fraud. The resulting 600-page report was reviewed by members of Leslie Fay's board and then submitted to the SEC and federal prosecutors. Although the report was not released publicly, several of its key findings were conveyed to the press. The most startling feature of the fraud was its pervasive nature. According to a company insider who read the report, "There wasn't an entry on the cost side of the company's ledgers for those years that wasn't subject to some type of rejiggering."⁸ The key focus of the fraudulent activity was Leslie Fay's inventory. Kenia and his subordinates had inflated the number of dresses manufactured each quarterly period to reduce the per unit cost of finished goods and increase the company's gross profit margin on sales. During period-ending physical inventories, the conspirators "manufactured" the phantom inventory they had previously entered in the company's accounting records. Forging inventory tags for non-existent products, inflating the number of dresses of a specific style on hand, and fabricating large amounts of bogus in-transit inventory were common ruses used to overstate inventory during the period-ending counts.

Other accounting gimmicks used by Kenia included failing to accrue period-ending expenses and liabilities, "prerecording" orders received from customers as consummated sales to boost Leslie Fay's revenues near the end of an accounting period, failing to write off uncollectible receivables, and ignoring discounts on outstanding receivables granted to large customers experiencing slow sales of the company's products. Allegedly, Kenia decided each period what amount of profit Leslie Fay should report. Then he and his subordinates adjusted Leslie Fay's key financial numbers until that profit figure was achieved. From 1990 through the end of 1992, approximately \$130 million of bogus entries were made in Leslie Fay's accounting records. These fraudulent entries overstated the company's profits by approximately \$80 million.

Kenia and his coconspirators molded Leslie Fay's financial statements so that key financial ratios would be consistent with historical trends. The financial ratio that the

8. T. Agins, "Report Is Said to Show Pervasive Fraud at Leslie Fay," *The Wall Street Journal*, 27 September 1993, B3.

fraudsters paid particular attention to was Leslie Fay's gross profit percentage. For several years, the company's gross profit percentage had hovered near 30 percent. Leslie Fay's actual gross profit percentage was approximately 20 percent by the early 1990s, but Kenia relied on his assorted bag of accounting tricks to inflate that financial ratio to near its historical norm.

Excerpts released to the press from the audit committee's report largely exonerated John Pomerantz of any responsibility for Leslie Fay's accounting irregularities. The report indicated that there was no evidence that he and other members of Leslie Fay's headquarters management team were aware of those irregularities but did criticize those executives for failing to aggressively pursue unusual and suspicious circumstances they had encountered during the course of Kenia's fraud. If those circumstances had been vigorously investigated, the audit committee concluded that the fraud might have been uncovered much earlier than January 1993. In particular, the audit committee questioned why Pomerantz had not investigated Leslie Fay's remarkably stable gross profit percentage in the early 1990s given the significant problems facing other women's dress manufacturers and the apparently poor response to many of the company's new product offerings during that period.

Following the completion of the audit committee's investigation in September 1993, Leslie Fay's board of directors allowed John Pomerantz to remain as the CEO but relieved him of all financial responsibilities related to the company's operations. The board created a committee of outside directors to oversee the company's operations while Leslie Fay dealt with the aftermath of the large-scale fraud. The board also dismissed Paul Polishan as Leslie Fay's CFO and Senior Vice-President of Finance and replaced him with an Arthur Andersen partner who had been involved in the audit committee investigation.

BDO Seidman: Odd Man Out

In April 1993, Leslie Fay filed for protection from its creditors under Chapter 11 of the federal bankruptcy code. Press reports of Kenia's fraudulent scheme had cut off the company's access to the additional debt and equity capital that it needed to continue normal operations. By early April 1993, the price of Leslie Fay's stock had dropped by nearly 85 percent since the first details of the fraud had become public two months earlier. The company's plummeting stock price and the mounting criticism of its officers in the business press triggered additional lawsuits by angry stockholders against Pomerantz, other Leslie Fay executives, and the company's longtime auditor, BDO Seidman.

The lawsuits that named BDO Seidman as a defendant charged that the firm had been at least reckless in auditing Leslie Fay's periodic financial statements during the early 1990s. Howard Schilit, an accounting professor and forensic accounting specialist, suggested in the business press that Leslie Fay's financial data had been replete with red flags. These red flags included implausible trend lines in the company's financial data, implausible relationships between key financial statement items and unreasonably generous bonuses paid to top executives, bonuses linked directly to the record earnings Leslie Fay reported each successive period. For 1991, John Pomerantz had received total salary and bonuses of \$3.6 million, three times more than the 1991 compensation of Liz Claiborne's CEO, whose company reported sales more than double those of Leslie Fay's.

BDO Seidman officials chafed at published reports criticizing their firm's Leslie Fay audits. Those officials insisted that BDO Seidman was being indicted in the press on the basis of innuendos and incomplete information since the full details of the

investigative report issued by Leslie Fay's audit committee had not been released to the public. These same individuals also maintained that Leslie Fay's top management, principally John Pomerantz, should shoulder the bulk of the responsibility for not discovering the massive fraud.

During various court proceedings following the disclosure of the Leslie Fay fraud, many parties questioned the objectivity of the forensic investigation supervised by Leslie Fay's audit committee that had largely vindicated Pomerantz and other top company executives. These skeptics suggested that the members of the audit committee had likely been reluctant to criticize the company's top executives who were their colleagues. To squelch such criticism, the federal judge presiding over Leslie Fay's bankruptcy filing appointed an independent examiner Charles Stillman, to prepare another report on the details of the fraud. Stillman was also charged with identifying the individuals responsible for the fraud and those responsible for failing to discover it.

In August 1994, the U.S. Bankruptcy Court released the so-called Stillman Report. This document corroborated the key findings of the audit committee investigation. Similar to the audit committee report, the Stillman Report largely exonerated Leslie Fay's top executives, including John Pomerantz, of any responsibility for the fraud. "The examiner's report concludes there is no evidence to suggest that viable claims exist against any members of Leslie Fay's current management or its board of directors."⁹ The Stillman Report went on to suggest that although there were likely viable claims against Kenia and Polishan based upon "presently available information,"¹⁰ the limited assets of those individuals made it economically infeasible for the bankruptcy court to pursue those claims. Finally, the Stillman Report indicted the quality of BDO Seidman's audits of Leslie Fay by asserting that there may be claims worth pursuing against "BDO Seidman," and that it is likely BDO Seidman acted negligently in performing accounting services for Leslie Fay.¹²

Following the release of the Stillman Report, Leslie Fay's stockholders filed a large civil lawsuit against BDO Seidman in the federal bankruptcy courts. At approximately the same time, BDO Seidman filed a lawsuit against Leslie Fay's principal officers, including John Pomerantz. In commenting on this latter lawsuit, BDO Seidman officials reported that "Leslie Fay's upper management not only tolerated fraud to bolster reported financial results but they benefited directly from its execution. As BDO Seidman has said from the beginning, we are victims of this fraud. As Leslie Fay's outside auditors, we were deceived by the company. Our reputation has suffered needlessly as a result of Leslie Fay's deliberate deception."¹³

Leslie Fay's management responded immediately to the news that BDO Seidman had named John Pomerantz and his fellow officers as defendants in a large civil lawsuit. "The unsubstantiated and unfounded allegations made today by BDO Seidman are a classic example of 'revisionist history' and are clearly an attempt by the accounting firm to divert attention from its own apparent negligence by blaming others."¹⁴

9. *Business Wire*, "Independent Examiner Confirms Findings of Leslie Fay's Audit Committee Investigation," 16 August 1994.

10. *Ibid.*

11. *Ibid.*

12. *Business Wire*, "Leslie Fay Responds to Unfounded Allegations by BDO Seidman," 29 March 1995.

13. *PR Newswire*, "BDO Seidman Announces Cross-Claims and Third Party Complaints Against Key Leslie Fay Figures," 29 March 1995.

14. *Business Wire*, "Leslie Fay Responds to Unfounded Allegations."

In July 1997, a federal judge approved a \$34 million settlement to the large number of lawsuits filed by Leslie Fay's stockholders and creditors against the company, its executives, and BDO Seidman. BDO Seidman contributed \$8 million to the settlement pool, although the firm claimed that it was agreeing to the settlement only because it was the most economical and expeditious way to "put this matter behind us."¹⁵ In June 1997, Leslie Fay emerged from federal bankruptcy court. Over the next several years, the much smaller company returned to a profitable condition before being purchased in late 2001 by a large investment fund. A few months later, in April 2002, John Pomerantz received a lifetime achievement award at the annual American Image Awards, a glitzy event sponsored by the major companies and organizations in the fashion industries.

On October 31, 1996, federal prosecutors filed a twenty-one-count fraud indictment against Paul Polishan. The specific charges included conspiracy, making false statements to the SEC, bank fraud, and wire fraud. Unknown to the public three years earlier, Donald Kenia had broken down under relentless questioning by federal investigators and admitted that Polishan, his former boss, had been the architect of the Leslie Fay fraud. According to Kenia's testimony, Polishan had overseen and directed every major facet of the fraud. Because of Polishan's intimidating personality, Kenia and several of his subordinates had agreed to make the enormous number of fraudulent entries in Leslie Fay's accounting records that he had demanded. Polishan had also compelled Kenia to accept full responsibility for the accounting irregularities when it became apparent in late January 1993 that the fraud would soon be exposed.

Following a series of lengthy and fiercely contested pretrial hearings, Polishan's criminal

case was finally heard in federal court in the summer of 2000. Polishan was convicted on eighteen of the twenty-one fraud counts filed against him. His attorneys immediately appealed the guilty verdict. The attorneys' principal contention during the appeal was that there was almost no physical evidence to link their client to the fraud. Instead, they maintained that Polishan's conviction had hinged almost entirely upon the veracity of Kenia's testimony.

The federal judge who presided over Polishan's appeal did not dispute his attorneys' principal contention. Throughout the fraud, the former CFO had been meticulously careful to avoid leaving incriminating physical evidence that linked him directly to the fraud. Despite that fact, the judge denied Polishan's appeal. The judge observed that a substantial amount of circumstantial evidence had been presented during the trial. After studying the evidence in painstaking detail, the judge ruled that it was much more consistent with Kenia's testimony than that of Polishan.

A key factor contributing to the judge's decision was the unusual relationship that had existed between Polishan and Kenia during their long tenure with Leslie Fay, a relationship that had been documented and discussed at length during the trial. The judge noted that Polishan had "dominated" Kenia through intimidation and fear. In the opinion he issued in the case, the judge referred on multiple occasions to an episode during 1992 to demonstrate how completely Polishan had controlled Kenia. In forcing Kenia to take responsibility for an accounting error that had been discovered in Leslie Fay's accounting records, Polishan had required Kenia to tell another company executive, "I am a . . . idiot."¹⁶

On January 21, 2002, almost exactly nine years after the news of the Leslie Fay fraud surfaced in the press, Paul Polishan was sentenced to

15. *The Electronic Accountant* (online), "BDO to Pay \$8 Million to Settle Leslie Fay Lawsuit," 10 March 1997. As a point of information, there is no public report of any resolution to the lawsuit filed against John Pomerantz, et al., by BDO Seidman. Most likely, that lawsuit was dropped by BDO Seidman following the settlement approved by the federal judge.

16. *United States of America v. Paul Polishan*, 2001 U.S. Dist. LEXIS 10662.

serve nine years in federal prison for his role in plotting and overseeing that fraud.¹⁷ Polishan, who filed for personal bankruptcy in 1999 claiming assets of only \$1,000, was also named \$900. After losing an appeal to overturn his conviction, Polishan reported to the federal correctional facility in Schuylkill County, Pennsylvania,

in early September 2003, to begin serving his nine-year sentence. In exchange for his testimony against Polishan, Donald Kenia was allowed to plead guilty to two counts of making false statements to the SEC. In 2001, Kenia was sentenced to two years in the Allenwood Federal Prison Camp in Montgomery, Pennsylvania.