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Whitaker Wright

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WHITAKER WRIGHT

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Fraud is a significant problem for contemporary businesses, but it is not a new problem. Business fraud was common during the 1890s. This paper examines several accounting issues that were central to Whitaker Wright's trial.

In 1904 a London jury convicted Whitaker Wright of issuing false balance sheets and the judge sentenced him to seven years penal servitude. Moments later in a courthouse waiting room Wright swallowed a lethal dose of cyanide. Thus ended the dramatic career of a corporate promoter, a speculator, and a leading figure in the Western Australian gold mining craze of the 1890s.

The prosecutors had charged Wright with issuing false balance sheets, a violation of the Larceny Act of 1861. The trial lasted two weeks and each day's testimony appeared in *The Times*. Wright's guilt or innocence hinged upon the propriety of his accounting practices. The testimony has many moments of drama and humor as Whitaker Wright steadfastly maintained his innocence in the face of an unsympathetic judge and overwhelming evidence of guilt.

Background

Whitaker Wright was born in England in 1845. At age twenty-one he migrated to the United States where he married and became a naturalized citizen. Wright began his career as an assayer and mining engineer. Successfully speculating in Colorado and New Mexico mines, he amassed a fortune of over one million dollars. He returned to England in 1889.

The 1894 discovery of massive gold deposits in Western Australia created a great demand in London for speculative mining ventures. Capitalizing on this opportunity Wright successfully promoted one venture after another. By 1899, Wright controlled several rich mines in Australia and Canada including the Lake View Consols, the Ivanhoe, and the Le Roy mines. He could have enjoyed a distinguished and rewarding career had he chosen to manage these companies prudently, but that was not in his nature.

Wright could not resist the lure of stock speculation. As the first person in London to receive cables from the mine superintendents, he occupied an excellent position to trade on inside information. Unfortunately for Wright, the manager of the Lake View Consols Mine decided to engage in a little insider trading on his own account. The mine manager fed false estimates of vast ore reserves to the London office. Relying on those reports, Wright speculated heavily. He gambled his own money and he gambled the funds of the companies that he controlled. The companies lost over £1 million during 1899 and early 1900, and these losses were rapidly overwhelming Wright's business empire. To recoup the losses and avoid financial ruin, he restored to additional insider trading. For that plan to work, Whitaker Wright needed cash, and he needed time. Thus, he hid the true condition of his companies by falsifying the financial statements of the London & Globe Finance Corporation for September 30, 1899 and December 17, 1990.

Accounting and Reporting Practices

At the annual 1899 shareholder meeting of the London & Globe Finance Corporation, Whitaker Wright boasted that the firm's large cash balance of £534,000 proved the strength and good management of the company. Yet only two days before the preparation of the financial statements the ledgers showed a cash balance of only £80,000. How did the cash account grow so quickly? According to the prosecutor, most of the change resulted from honest, although unusual, transactions. However, the prosecution challenged one transaction that involved £72,000 in cash received from the Standard Exploration Company, another Wright company. London & Globe accountants recorded this transaction as a cash sale of an investment in Nickel Corporation stock. Nevertheless, the Standard's accountants recorded this transaction as a short term loan to the Globe secured by the Nickel Corporation stock. These two treatments might appear to be the result of an honest difference of opinion. Whose accountants were right, the Globe's or the Standard's? Actually, they were the same people because accounting for both companies was handled by a common staff operating out of a single London office.

Whitaker Wright delayed the preparation of the annual report for 1900 until December 17 as he frantically adjusted (cooked) the accounts. Wright testified there "was no strict date for the making up of accounts. Mining companies made them when it suited them" (*The Times*, Jan. 21, 1904). In 1900, British law permitted corporations to issue annual reports on any date within the calendar year. The Globe reported a profit of £479,000, but the prosecutor claimed there were several major errors in the earnings figure.

One alleged accounting error involved underwriting commissions recognized as revenue. This complex tale begins with Victoria Gold Estate Ltd, a firm whose largest asset consisted of gold claims that could not be profitably exploited because of technical problems. Thus, the company's primary asset was nearly worthless. Whitaker Wright concocted a scheme of splitting Victoria Gold Estate's property between two new firms, Lodden Valley and Moorlort. He organized Lodden Valley on November 23, 1900 and London & Globe received 20,000 Lodden shares as a commission. The London & Globe accountants recorded these shares at their par value although the Lodden's mineral claims had little, if any, value.

Perhaps to confirm this valuation on November 30, 1900, London & Globe sold the 20,000 Lodden shares to British America Company for £100,000. On the same day British America Company paid another £100,000 for 20,000 shares of Moorlort common. The second sale was remarkable because Moorlort Company did not exist until the following day.

A second error illustrates the difficulty of maintaining consistency while manufacturing events and manipulating accounts. From July through September 30, 1900, London & Globe received loans from three affiliated Canadian mining companies. Wright settled these debts by recognizing an expected distribution of profits from the same three firms. Unfortunately, London & Globe had already sold all of its investments in the three mines on Nov. 22, 1900. Thus, it no longer held any shares upon which to expect a distribution. Wright must have lost track and sold the investment before he declared the dividends. Even Whitaker Wright admitted that this was an error that he courageously blamed on the company accountants.

Another important issue involved accounting for investments in equity securities, the Globe's largest category of assets. The balance sheet stated these investments were carried at the lower of cost or market. The following testimony by Wright (*The Times*, Jan. 20, 1904) relates to the investment accounts:

> The Prosecutor—Has market value anything at all to do with your balance-sheets?
> Wright—I do not think it has much.
> The Prosecutor—Has it anything?
> Wright—The rule is that we do not consider market value.
> The Judge—Then this is imagination that "if the market value of the shares was less than cost, they were marked down to market value"?
> Wright—It is the sort of statement 99 chairmen out of 100 would make at a shareholders' meeting. (Laughter.)

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Wright explained that investments were valued at average cost if acquired for cash, and at par value when exchanged for mine property. On December 17, 1900 the investment account had a balance of £2.3 million. If these investments had been recorded at fair market value, the account would have had a balance of about £1 million.

The most important business event of 1900 for London & Globe Finance Company was the loss incurred from speculating in Lake View Consol shares. Wright concealed this event by transferring the loss to an affiliated company. On November 29, 1900, Wright transferred to the Standard Exploration Company an investment of £1.6 million in Lake View Consols common. As part of the transaction he also eliminated London & Globe's related liability. This was a sham transaction that was reversed one month later when London & Globe Finance Company announced that it was insolvent. The market value of this investment was far less than the book value.

Conclusions

The case of Whitaker Wright contained several red flags that should have warned the auditors, but did not. For instance, Wright was a promoter of Western Australian gold mines. This was a high risk business with a history of stock manipulations. In similar situations, such as the savings and loan industry of the 1980s, auditors should have been especially careful. In addition, Wright's extravagant lifestyle should also have been viewed as a sign of his fraudulent activities. The frequent sales of mineral claims between affiliated companies controlled by Wright indicated the possibility of a deception. The delay of the 1900 annual report signaled a clear warning to all interested parties. Finally the flurry of large and unusual transactions that always occurred just before the end of the fiscal year should have alarmed the auditors. With so many red flags, it is surprising that the fraud remained undetected for so long.

Whitaker Wright issued false balance sheets with the intent of deceiving investors and creditors. Many people were harmed by his schemes, and he was not selective about whom he hurt. Nonetheless, it is difficult to sympathize with the stockholders because gold mines are an inherently risky investment. Pensioners, widows and orphans should not invest in such enterprises. In his defense Wright argued that his accounting and business activities were commonplace in the mining industry. Wright seemed to be genuinely surprised that he had been charged for such practices. In fact, it was unusual to be arrested for issuing deceptive financial reports in 1900. The reporter for the *New York Times* did not believe that Whitaker Wright's activities would have constituted criminal behavior under the laws of the United States. However, he concluded that American investors would sleep better if our business laws were more like those of the United Kingdom.

References

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The Times, (London), Jan. 12-29, 1904.

A THOUGHT FROM THE PAST

"Culture is activity of thought and responsiveness to beauty and humane feeling."

—A. N. Whitehead