

# THE RISE AND FALL OF THE FTX GROUP

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## TEACHING NOTE

### CASE DESCRIPTION

*The case discusses the eight billion dollars of customer funds misappropriated at one of the world's largest cryptocurrency exchanges and the resulting 25 years prison sentence of its founder. The case exposes students to corporate governance policies within an organization, and the importance of establishing sound control environment principles even in a non-public entity. The case can be used in an undergraduate or advanced auditing class and students can utilize the Committee on Sponsoring Organization or COSO framework to formulate responses. The COSO framework defines internal control, including corporate governance, and provides a systematic approach to internal control evaluation and assessment. The case can also be used in a management course that discusses leadership and/or corporate governance issues. The case is designed to be taught in one class period and is expected to require approximately two hours of outside preparation by students. The case is based on real events as reported in various media outlets*

### CASE SYNOPSIS

*Sam Bankman-Fried (SBF) was known for a while as a corporate titan and one of the youngest billionaires in the world, with a net worth of over \$20 billion, and the rare, good guy in the crypto industry. In March 2024, he was sentenced to 25 years in prison for failing to safeguard \$8 billion in customer funds. The rise and fall of his firm FTX was rapid – in only four years, this high-flying crypto currency exchange collapsed from a \$32 billion entity to its chapter 11 bankruptcy filing. During its existence, FTX spent lavishly on political campaigns, and marketing and branding deals. At one point, FTX had business relationships with major sporting entities and personalities including the Miami Heat, Major League Baseball, the Golden State Warriors, Mercedes Benz Formula 1, Tom Brady, Shohei Ohtani, and David Ortiz. After the bankruptcy filing, members of the leadership team were arrested and most agreed to cooperate with federal prosecutors. These deals led to the indictment and the successful prosecution of the founder, SBF.*

### RECOMMENDATIONS FOR TEACHING APPROACHES

The objective of the case is to expose students to corporate governance policies within an organization, and the importance of establishing sound control environment principles even in a non-public entity. The case is flexible and can be used in several different situations. For

instance, it could be used in any course that has a fraud or ethical component, or one that discusses leadership and corporate governance. The case is easily adopted for use at both the graduate and undergraduate levels. Although designed for an auditing class, the case could be easily used in a management course on leadership.

The case can be completed on an individual or team-based project, and as an in-class or out-of-class graded assignment. The group size, grading scale and assigned points are at the specific instructor's discretion. If the case is used as an in-class activity, the students should read the case prior to attending class and the discussion questions should be answered in class. Students without prior knowledge of crypto currency and crypto exchanges are encouraged to read the background information on the industry, prior to attempting the case. One such source is "How Do Crypto Exchanges Work? Everything You Need to Know" available at <https://moneymade.io/learn/article/how-do-crypto-exchanges-work>

We addressed this case from a Committee on Sponsoring Organization of the Treadway Commission or COSO framework perspective. Therefore, instructors using our approach should ensure that students review the executive summary of the COSO framework (available at [coso.org](https://www.coso.org)) prior to responding to the discussion questions.

### **LEARNING OUTCOMES**

Students will be able to:

1. Understand the and apply the control environment component of the Committee of Sponsoring Organizations of the Treadway Commission (or COSO) framework
2. Identify basic fraud prevention techniques

### **CASE FEEDBACK**

The case was presented at two academic conferences - International Society of Marketing & MBAA International, Fall Educators' Conference and the IGBR Spring Conference – and was positively received. All feedback provided from these conferences was incorporated into the case discussion.

### **DISCUSSION QUESTIONS**

Provide answers to the following questions:

Q1. The "tone at the top" is considered a key component of an organization's corporate governance process. Use the fundamental principles within the control environment component of the Committee of Sponsoring Organizations of the Treadway Commission (or COSO) framework to discuss:

- i. The company's commitment to integrity and ethical values
- ii. The Board of Directors' independence from management
- iii. The structures, reporting lines, and appropriate authorities and responsibilities established by management in the pursuit of objectives
- iv. The organization's commitment to attract, develop, and retain competent individuals

- v. The organization's ability to hold individuals accountable for their internal control responsibilities

[Note: Use Appendix A to answer each of the above in terms of both the *design* and *operating* effectiveness of the control environment]

Answer: See responses in the Appendix A

*Q2. Comment on the company's overall design of the control environment*

Answer: As noted in Appendix, the organization control environment was flawed. In fact, it did not control in place to address any of the five guiding principles of this COSO component.

*Q3. Comment on the overall effectiveness of the control environment*

Answer: without an appropriate control design, the control effective cannot be addressed. As such, this element was also ineffective.

*Q4. Was the fraud preventable? If so, identify steps that could have been taken to prevent it from occurring.*

Answer: Yes. A non-existing control environment and poor "tone at the top" played a significant role in the fraud. The tone of the top is important since it sets the standard of the appropriate behavior expected of individuals at all levels of an organization. Clearly, the fraud could be prevented if the guiding principles from COSO's control environment were in place. For instance:

- The organization could create an independent board of directors that could provide oversight
- An established board would result in the formation of an internal audit function to help it perform its oversight responsibilities
- The organization could have a human resources (HR) director and develop an effective HR function that would enable it to attract and retain competent individuals who lacked integrity or demonstrated in-appropriate ethical behavior. In addition, it lacked
- A Code of Ethics or Behavior would establish the expectations for integrity and ethical behavior
- A formal evaluation process would ensure that individuals are held accountable for their internal control responsibilities

## EPILOGUE

SBF was arrested in December 2022 and charged with 13 criminal counts. Four additional charges including bank fraud, were added in February 2023. An additional foreign bribery charge was later added for conspiracy to pay a \$40 million bribe to a non-US official to

unfreeze \$1 billion in funds. The head of FTX is expected to go to trial in October 2023 to face these charges.

Three top FTX executives who were closely aligned with Bankman-Fried were arrested and faced assorted charges for their roles in the embezzlement. In December 2022, Ellison and Wang both plead guilty of fraud. In February 2023, Singh pleaded guilty to multiple charges including wire fraud, commodities fraud, securities fraud, money laundering, and campaign finance violations. All three plead guilty to fraud and agreed to cooperate with federal prosecutors.

In November 2023, the fourth top lieutenant of SBF, Salame, pleaded guilty to criminal charges and agreed to pay millions in fines and restitution to FTX. He also agreed to forfeit two properties along with his Porsche. He faces up to 10 years in a federal prison upon sentencing.

Meanwhile, firms that with close financial ties to FTX are also facing their own challenges. BlockFi, a cryptocurrency lender and financial services firm founded in 2017, filed for its own Chapter 11 bankruptcy protection in November 2022. Two months later, Genesis Trading (part of the Digital Currency Group) a major FTX creditor filed for Chapter 11 bankruptcy protection.

SBF was convicted in November 2023 of seven counts of fraud, conspiracy, and money laundering, and faced a maximum of 110 years in prison. He was sentenced in March 2024 to 25 years in prison and ordered to forfeit more than \$11 billion in assets. He is still facing a second trial in 2024 on campaign finance violations and other charges.

FTX filed a lawsuit against SBF's parents accusing them of receiving inappropriate gifts such as a \$16 million home in the Bahamas and \$10 million in cash. The lawsuit is still pending at the time of our case.

### **DISCLAIMER**

This critical incident and teaching note were prepared by the authors and are intended to be used for class discussion rather than determining either effective or ineffective handling of the situation. The events described in this case are based on real-world situations as reported in various public sources.

**APPENDIX A: THE COSO FRAMEWORK – CONTROL ENVIRONMENT**

COSO Component – Control Environment	Related Principle	Comment on the design <sup>1</sup> or existence of this principle within the organization	Comment on the operating effectiveness <sup>2</sup> of this principle within the organization
	i. The organization demonstrates a commitment to integrity and ethical values.	The case is about the misappropriation of customer funds. Clearly, the principle of integrity and ethical values was not in place within the organization.	This cannot be addressed since the design was flawed or non-existent
	ii. The board of directors (BoD) demonstrates independence from management and exercises oversight of the development and performance of internal control.	The organization did not have a BoD. Instead, it was governed by a leadership team consisting of Bankman-Fried and his friends. Therefore, this principle was not in place in the organization	This cannot be addressed since the design was flawed or non-existent
	iii. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.	The principle was not in place since there was no BoD to provide oversight. As noted, the organization was managed by a small group of friends with little authority. The case suggest that major decisions were made by one person (Bankman-Fried), with implied approval by the others	This cannot be addressed since the design was flawed or non-existent
	iv. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives	This principle was not in effect within the organization. The case noted that there was no human resources function or leader. Instead, Bankman-Fried relied on a close group of associates to manage the organization. It seems challenging for an organization with more than 108 entities in multiple jurisdictions to have only 300 employees to manage the operations	This cannot be addressed since the design was flawed or non-existent
	v. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives	The organization spent lavishly on marketing deals and on contributions to charity and political parties. In fact, Bankman-Fried	This cannot be addressed since the design was flawed or non-existent

	involved family members and other associates in some of these endeavors. The case suggests that this principle was not in place since the individuals involved were not held accountable by the organization. Accountability occurred after the bankrupt filing and via the legal system	
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