

Case Study – Touch Choices



City of Dixie (fictional)

- Budget cuts and problem with pension fund
- Revenues not decreasing but negative cash flow for three years
- Accounting staff cut back to two: Kimberly (comptroller and treasurer) and Cathy (accounting specialist)
- Cathy's concerns:
 - Cathy discovered new account "DCDA Dixie Capital Development Account"
 - Kimberly is only signatory
 - Several large checks made out to "Treasurer"
 - Several large amounts
 - Cathy is not allowed in Kimberly's office
 - Kimberly works a lot of Sunday nights to do routine bookkeeping tasks
 - Kimberly buys hot chocolate and pastries for the staff on Monday a.m.
 - Kimberly does not take vacations; is very lax with Cathy on work hours
 - A "fabulous" boss
 - Kimberly is "wealthy" and very generous

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Touch Choices – Discussion Questions



- Using the fraud triangle, identify the internal control weaknesses and fraud risk factors that were present in this case. How might these risk factors and control weaknesses contribute to a fraud?
- What role can management accountants play in preventing and detecting fraudulent activities and other illegal activities?
- Based on what Cathy observed, do you think Kimberly is doing something unethical? Do you think Cathy is doing something unethical? Defend your answers.
- Who is being affected if Kimberly is embezzling funds? Who is being affected by Cathy's decision to keep her concerns to herself?
- Assume Cathy feels that Kimberly is doing something wrong. What options does she have to handle the situation? Provide at least three possible options. Which of these options do you think would be best? Why?

Tough Choices: Ethical Decisions in Whistleblowing

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INTRODUCTION

The city of Dixie recently made headlines because of budget cuts and problems with the pension fund for city employees. The city has never had financial difficulties before. Most of the residents in the community have an income well above the national average. Their large houses have always provided significant cash flows to the city through property taxes, and their local shopping provides extra revenue through an additional sales tax. Because of this stability, the city had, until recently, boasted an impressive fire department, an extensive police force, and many other services, attracting talented individuals away from nearby communities with their high salaries and very competitive pensions.

While revenues do not appear to be dropping, the city's cash flows have been negative for the past three years, cutting deeply into the mayor's emergency fund and into local coffers. The problems have become so severe that the fire department and emergency medical technician (EMT) services have held fundraisers and solicited donations to stay operational and meet their salary commitments. Other public services, such as road repair and park maintenance, have also started to suffer.

A few prominent businesses and members of the community have already moved away because of these problems, and rumors that many others are beginning to consider moving have flooded the mayor's office. The loss of a large number of affluent citizens or successful businesses would be disastrous for the struggling community, making city leaders desperate to find a solution to their current cash crunch.

In a meeting of all the senior public officials and financial officers of the town, the mayor and city council offered a plea to cut costs wherever possible, to downsize if necessary and to look for any clues as to where the city funds are disappearing. The frank discussion of the city's position unsettled many of the leaders, especially Cathy Clark. Cathy is an accounting specialist, the community's *only* remaining accounting specialist due to the recent cuts. Cathy and Kimberly Hedges, the city's comptroller and treasurer, make up the entire finance department for the city.

As the mayor talked, Cathy started to worry. Could the trouble be in the comptroller's office? She hoped not but was starting to wonder. While the mayor continued to talk, Cathy recalled a couple of specific incidents in the past few weeks that worried her. The first was a discussion of a strange account Cathy had found almost two months ago. The second was a conversation about workload that happened just two weeks ago.

TWO MONTHS BEFORE THE MEETING: THE DCDA ACCOUNT

"Kim, can I talk to you for a minute?" Cathy called out to her boss through Kimberly's open door. Cathy had a hard time with such informal behavior when she came to Dixie from a large corporation in Seattle, but Kimberly encouraged a relaxed atmosphere. She felt that it was important for the Comptroller's office to mirror the atmosphere in the small town. And she hated being interrupted in her office. Cathy had always thought it was weird that Kimberly would rather come to her than have Cathy go into her office, but the pay

was good enough and the job comfortable enough that she certainly wasn't going to complain about something so simple.

"What do you need, Cathy?"

Kimberly's question brought Cathy's mind out of the clouds. "I just had a question about this new account," she said quickly.

"New account?" Kimberly asked, frowning. "What new account?"

"This one," Cathy pointed to the new line on her spreadsheet: DCDA Dixie Capital Development Account. "I haven't seen this one before."

"Oh, it's been around for a while," Kimberly said, looking back at her office. "Maybe you haven't seen it because nothing's gone through there for a while."

"Maybe," Cathy agreed with a frown. "But it's still weird. I mean, it looks like you are the only signatory on the account. Don't all of the accounts need at least two signatures?"

Kimberly smiled. "Oh, so that's the trouble. Your internal auditing buzzers are going off. That's a pet account of the mayor. He uses it to take care of potential investors that come in and for hosting parties for the staff and the other small costs. Since the amounts are so small, he and I just take care of it."

"There are several very large transactions," Cathy noted, "and some of the checks were made out to 'Treasurer.'"

"Well, my dear," the older woman responded as she usually did when Cathy started to get on her nerves with lots of questions, "we're trying to bring in new businesses and keep people from moving away. Of course we're spending a little more of those kinds of funds." She looked at the clock. "Look, I'll tell you what. You look tired. Since it's already almost 3 p.m., why don't you go home and get some rest. I'll talk with the mayor about these funds the next time I see him, and I'll try to get him to control his spending. Okay?"

Cathy felt a twinge of guilt, but then again, who was she to argue with the boss? Kimberly let Cathy leave early when she needed to, never docked her any pay, and never expected her to make up the hours. And there was that new restaurant that she has wanting to try. This account obviously had a political agenda, so why not leave it to the politicians? She'd go enjoy a quiet afternoon. It wasn't until later that day that she wondered if Kimberly had been trying to get her out of the office for more than just politics.

TWO WEEKS BEFORE THE MEETING: WORKING WEEKENDS

Cathy smiled as she settled into her office chair, a hot chocolate from a local coffee shop in one hand and a fresh donut in the other. She loved coming to work on Monday mornings. How many people could say that? Recently, Kimberly had started providing hot chocolate and pastries every Monday to make the day more pleasant, she claimed. Monday's workload was also lighter now. That's because Kimberly had started coming in on weekends to work on some of the more trivial projects, which if left until Monday probably would have made the Monday morning workload a nightmare.

Cathy had tried to argue with her a month before when she had come in to find so much done. "I have nothing to do now on Monday mornings. Besides, bookkeeping tasks are supposed to be my job. Why don't you let me take care of them?"

As always, Kimberly had laughed nervously and waved her hand in the air. "You're not a bookkeeper, Cathy. Your job is to take care of the budgets, file the financial records and make sure that we're in compliance with local ordinances. Nowhere in that description does it say that you are supposed to do bookkeeping."

"It says 'other duties as assigned.' I'd be happy to take care of that stuff for you like I have been, as well as picking up the mail like you've been doing. I'm supposed to make your life easier, not leave you to take care of all of these little details."

"Oh, Cathy," Kimberly sighed. "To be honest, I wish I could let you take care of this stuff. But the truth is that I've started suffering from terrible insomnia on Sunday evenings. I don't know if it's nerves about the politics and meetings I know are starting the next day, or just a problem with my bed. Maybe it's the horses being restless. I don't know. All I know is that I can't settle down on Sunday nights, so instead of watching TV, I come in and get some work done. That way, if I get some work accomplished, it makes me feel better about the lack of sleep."

"Well, why don't you work on some of your own projects? At least then you would be making headway and maybe lighten your own workload for the coming week."

Kimberly laughed nervously again. "My projects *never* get done," she said, shaking her head. "So, I work on yours. Yours have a definite beginning and ending, and by the time I get sleepy, I have a nice thick stack of invoices paid, accounts reconciled, and checks printed."

Cathy shrugged her shoulders. "Well, you're the boss. You can do what you want."

"Thank you for noticing," Kimberly said dryly.

Cathy smiled then looked at Kimberly in concern. "Maybe you should take a trip. You know, a nice vacation. That would give you the opportunity to unwind and relax."

"No!" Kimberly's voice was sharp, then she mellowed. "No, I can't do that in this crisis. There are things I have to do myself. With only the two of us in the office, only I can do them."

"I am a CMA too, you know," Cathy began, but Kimberly cut her off with a wave of her hand.

"I know, but then I'd have to train you. It's less work for me to just do it myself."

Cathy bit her tongue to keep from mentioning that Kimberly would only have to do that once. After that, she could have more time for her projects and have some vacation time. Obviously, her boss didn't want to think about vacations right now. Knowing how much money Kimberly earned, Cathy didn't really understand why she didn't take more time to enjoy it. But she could sort of understand Kimberly's desire to help ease the financial crisis. Still, given how slowly governments moved, even small town governments, surely Kimberly had time to plan one weekend vacation.

LATER THAT EVENING: TOUGH CHOICES

Cathy sat on the couch, looking out over the small meadow behind her house. She didn't even hear her husband, George, come in or feel him sit down next to her.

"A penny for your thoughts?" he finally said quietly.

Cathy looked over at George and smiled. "They're pretty depressing thoughts. Perhaps, I should pay you for them instead." George just smiled back at her and she sighed. "I'm a little worried about the town."

"You mean the financial crunch?"

"Yeah, I think Kimberly might be behind it."

"What?" George sounded shocked. "How could Kimberly be behind it? She's the hardest worker I know, and she's cut the department down to about nothing. I mean, it's just the two of you, right? And she does so much of the work herself."

"I know, I know. I'm probably wrong." She paused.

"But," George added. "You're afraid you're right." Cathy nodded. "What do you think Kimberly's doing, stealing from the city?" he asked sarcastically.

"She could be!" Cathy protested. "And I have an obligation to report a fraud if I find one."

George shook his head with a smile. "Come on, Cathy. Do you really think Kimberly would be involved in a fraud? She's one of the wealthiest people I know. She has that huge ranch. What does she call it?"

"Stepping Stones Stallions."

"Right. And it just keeps getting bigger. I mean, didn't she just add another champion stud?" Cathy nodded.

"Right, and look at the way she treats everyone. She takes us to dinner, and takes you out for lunch all the time, buys nice Christmas gifts for us and the kids, and what about those expensive tickets for the horse show that she gave to everyone in city hall? She's loaded."

"Maybe," Cathy said, still sounding doubtful, "but she doesn't enjoy it."

"What's that supposed to mean?" George asked.

"Well, take that horse show you mentioned. She's the only one who didn't go, other than the emergency staff. She begged off at the last minute. And she never goes on vacation or goes to races any more. I leave early and come in a little late, because she insists that I do, but she's working all the time. Why doesn't she ask me to help with all of the work that needs to be done? It just doesn't seem right."

"Okay," George agreed. "You're right. She's definitely a workaholic. But that doesn't mean she's a criminal. Her family's been in the area for generations. They're well-respected but keep a low profile. Maybe she's just spending the family fortune."

Cathy still looked concerned. "Well, what about the recent audit? Wasn't it one of the big firms? And didn't they sign off with only minimal issues? I know, I know. It was a big regional firm, but they didn't actually come to the offices themselves. They hired a local CPA do the leg-work. He's done lots of small audits, but he isn't really capable of doing everything that needed doing if there's a suspicion of fraud. And there's more to it than that. I told you about the DCDA account that I found a few months ago, right?" George nodded. "Well, I did a little more digging, and several of the invoices that support the payments made from that account look suspicious. The invoices are not on proper letterhead and don't have approved contracts. In fact, it looks like most of the building projects didn't even happen. Also, I found several more checks made out to 'Treasurer,' and many of them were not supported by invoices either. They add up to a pretty large amount."

"Well," George threw up his hands, "if it bugs you that much, then perhaps you should talk with the mayor or a member of the city council about it. You won't be able to sleep until you do."

Cathy shook her head. "How can I do that, George? What if I'm wrong? I'd be slandering the best boss I've ever had. It could be nothing, just coincidences. How can I report something that might not even exist?"

CASE QUESTIONS

In answering the following questions, use the Association of Certified Fraud Examiners (ACFE) “The Fraud Triangle” and the *IMA Statement of Ethical Professional Practice* for guidance.¹

1. The “fraud triangle” has been used to identify conditions or circumstances that typically present in financial frauds. It consists of three components, which together lead to fraudulent behavior: (1) Perceived financial need, (2) Perceived opportunity, and (3) Rationalization. Using the fraud triangle, identify the internal control weaknesses and fraud risk factors that were present in the case. How might these risk factors and control weaknesses contribute to a fraud?
2. What role can management accountants play in preventing and detecting fraudulent activities and other illegal activities?
3. Based on what Cathy has observed, do you think Kimberly is doing something unethical? Do you think Cathy is doing something unethical? Defend your answers.
4. Who is being affected if Kimberly is embezzling funds? Who is being affected by Cathy’s decision to keep her concerns to herself?
5. Assume Cathy feels that Kimberly is doing something wrong. What options does she have to handle the situation? Provide at least three possible options. Which of these options do you think would be the best? Why?
6. Assume that Cathy had confided her concerns to you and her desire to come forward and report those concerns. What arguments could you use to help support Cathy in her decision? Provide at least three logical arguments.
7. What do you think Cathy should do in this situation?

¹ “The Fraud Triangle,” Association of Certified Fraud Examiners (ACFE), <http://www.acfe.com/fraud-triangle.aspx>; *IMA Statement of Ethical Professional Practice*, IMA, http://www.imanet.org/docs/default-source/press_releases/statement-of-ethical-professional-practice_2-2-12.pdf?sfvrsn=2

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