

Mission Impossible: When Benchmarks Undermine Ethics

Participant Workbook

IMA Ethics Series

TODAY'S AGENDA

1. Introduction
2. Creating an Ethical Culture
3. Case Study: A Cash Cow?
4. Case Study: Troubled Waters
5. Close

LEARNING OBJECTIVES

After this session, you'll be able to:

- Identify elements of the fraud triangle and explain how to overcome them.
- Define short-termism and describe how to avoid it.
- Apply the *IMA Statement of Ethical Professional Practice* to various real-world ethical dilemmas.
- Explore the pressures and complexities associated with ethical dilemmas.
- Evaluate potential courses of action and their possible consequences when seeking to resolve an ethical dilemma.
- Summarize how to build an ethical culture.

REFLECTION

1. What elements are important in creating an ethical organizational culture?
2. What actions should an organization take to ensure an ethical culture?

AN ETHICAL CULTURE

- Key aspect of good governance
- Leads to many favorable strategic outcomes, which can impact the bottom line
- Attracts superior employees, reduces turnover, and achieves a lower cost of capital
- Unethical behavior can quickly diminish the reputational value of a brand



THE FRAUD TRIANGLE



FRAUD DEFINED

Intentional deception committed by an employee or organization for personal gain.

OPPORTUNITY

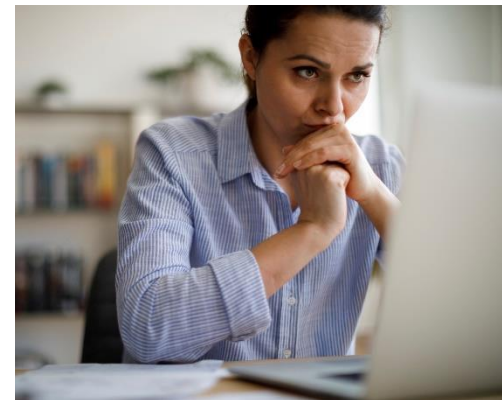
- Weak internal controls
- Poor tone at the top
- Inadequate accounting policies

INCENTIVE

- Bonuses based on a financial metric
- Investor and analyst expectations
- Personal incentives

RATIONALIZATION

- “They treated me wrong.”
- “Upper management is doing it as well.”
- “There is no other solution.”

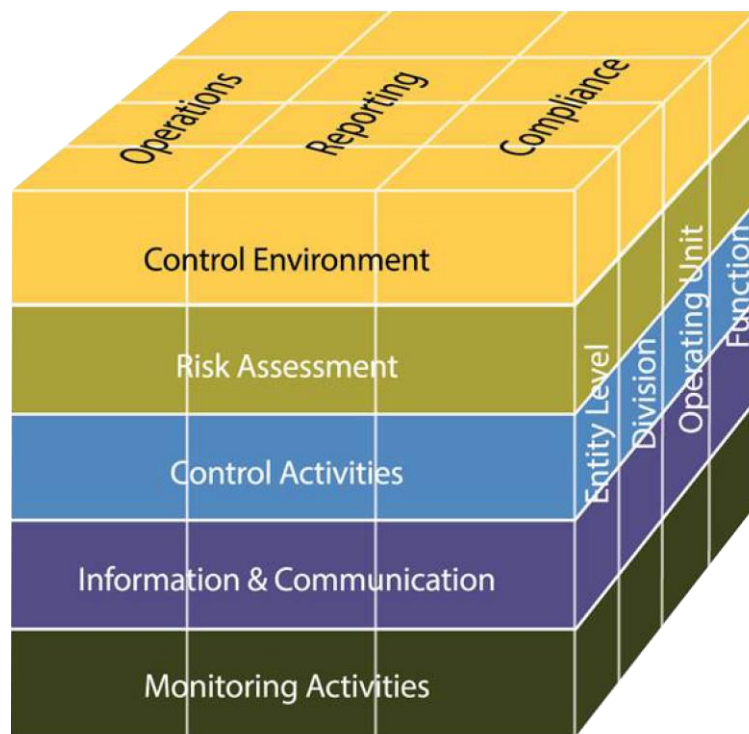


OVERCOMING OPPORTUNITY

Internal Controls

A process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

COSO INTEGRATED FRAMEWORK



Objectives

Components

Organizational Structure

Source: Committee of Sponsoring Organizations of the Treadway Commission (COSO),
Internal Control—Integrated Framework, May 2013.

OVERCOMING RATIONALIZATION

- Invest in ethics training that's tailored to the organization.
- Conduct annual surveys of employee attitudes.
- Establish effective whistleblowing programs.



OVERCOMING INCENTIVE

- Improve the organization's ethical culture.
- Expand performance measurements to include more than short-term financial measures.
- Invest in people.



PAIR AND SHARE

Share an example of one point of the fraud triangle from what you have read or from your own experience.

SHORT-TERMISM

When people and/or organizations focus excessively on short-term results at the expense of long-term interests.

“Short term” can mean different things in different contexts.

OVERCOMING SHORT-TERMISM

- Think strategically
- Strengthen the tone at the top
- Don't forget the rest of the organization
- Put less emphasis on quarterly results
- Foster robust internal and external communication
- Commit to continuous learning



PAIR AND SHARE

Share an example of short-termism from what you've observed or heard about.

IMA STATEMENT OF ETHICAL PROFESSIONAL PRACTICE

Requires IMA members to contribute to a positive ethical culture in their organizations.

Members must take an active role in ensuring their organization has a strong, open, and positive ethical culture.

IMA'S OVERARCHING ETHICAL PRINCIPLES



Honesty



Fairness



Objectivity



Responsibility

STANDARDS

Competence

Confidentiality

Integrity

Credibility

IF POLICIES DON'T EXIST...

1. Talk with your immediate supervisor
2. Call the IMA Ethics Helpline for advice
3. Consult your own attorney
4. If resolution isn't successful, consider disassociating from the organization

CASE STUDY: A CASH COW?

BOB BOWMAN

- From a long line of dairy farmers
- His father and older brother run Bowman Farms
- Has an extremely analytical mind
- Graduated at the top of his class with dual major in accounting and information systems
- Chose to work for a corporate dairy company, Hester's Dairy
- Entry-level cost/financial analyst
- Assured his family he was learning the latest business practices to acquire skills to return to the family business later



THE PROMOTION

- Bob showed a lot of promise and acquired a fantastic reputation for his technical and strategic knowledge.
- After seven years, not as many promotions as his peers
- Considered a little too “country” for the corporate culture
- Hester's Dairy's CEO, Grant, offered Bob a senior vice-presidency and to lead a project for the company's organic dairy products.
- The division was stuck at a 5% profit margin, but the CEO and the board of directors expected a 30% profit margin.
- Despite thinking the goal was unrealistic, Bob gives a farmer's oath to do “whatever it takes” to meet those expectations.

DISCUSSION

Was it ethical for Bob to take a job with Hester's Dairy if he was planning on using what he learned there to eventually help his family-owned business, Bowman Farms?

THE NUMBERS

Organic Dairy Product Line Profit Report		
Organic Dairy	Actual	Expected
Revenue	\$13,800,000	\$13,800,000
Cost of goods sold	\$13,110,000	\$9,660,000
Profit	\$690,000	\$4,140,000
Profit margin	5%	30%

CHANGES FOR BOB

- Former coworkers didn't want to talk to Bob.
- Many employees in the organic products division were older.
- Bob became isolated and had no one to confide in or seek advice from.

BOB'S SOLUTION

Three months later...

- Bob identified and eliminated certain inefficiencies
- Also targeted specialty markets through direct competition with smaller dairies
- Able to project reduced costs and slightly increased revenues but only an 8% profit margin

Organic Dairy Product Line Profit Report		
Organic Dairy	Present	Projected
Revenue	\$13,800,000	\$14,000,000
Cost of goods sold	\$13,110,000	\$12,880,000
Profit	\$690,000	\$1,120,000
Profit margin	5%	8%

MEETING WITH GRANT

- Grant reminded Bob of his promise to do “whatever it takes”
- Recommended that Bob compare product costs for organic and nonorganic dairy products

Comparison Product Line Profit Report for Organic Using Nonorganic Costs		
Organic Dairy	Present	Projected
Revenue	\$13,800,000	\$13,800,000
Cost of goods sold	\$13,110,000	\$9,680,000
Profit	\$690,000	\$4,140,000
Profit margin	5%	30%

Bob realized:

- If he sold nonorganic as organic, he could meet the required profit margin
- Mislabeling would likely not be discovered
- Mislabeling would likely not harm anyone

CALL FROM GRANT

- Urgent to achieve 30% profit margin starting next quarter
- 30% only needed for one or two quarters
- Reminded Bob that his strategies had already wreaked havoc on smaller dairy farmers
- If Bob wasn’t willing to do “whatever it takes,” there were others who understood the opportunity Bob had received
- Grant closed with telling Bob to get back to him tomorrow, but if the company wasn’t at 30% for the next two quarters, Bob would be fired

SMALL GROUP DISCUSSION

1. Should Bob have given a farmer’s oath to the CEO? Is he ethically bound by this oath?
2. What would you do if you were Bob?



EPILOGUE

In this case, we saw:

- Fraud motivated by incentive
- Some lack of internal controls
- Poor tone at the top
- Short-termism



CASE STUDY: TROUBLED WATERS

WATERS PAPER CORPORATION

1800s: WPC established as publicly traded company to convert the upper-Midwest's forests into paper products.

World War I: Developed casi-cotton to support surgeons. It would later be the basis for SneezEase and SanEase products.

1950s: Concentrated on organic domestic growth followed by several decades of international expansion.

2019: Worldwide leader in personal care products with annual revenue of \$20 billion and 42,000 employees.



THE EMPLOYEES



Tom Vollmer
CEO



Claire Fleming
CFO



Rachael McBride
Accountant



Chris Schmidt
CIO



THE CASE

- WPC supports several legacy computer systems.
- Prior to January 1, 2000, the company transitioned to single enterprise resource planning (ERP) system.
- Real-time information from ERP helped WPC increase operational efficiency.
- Each year, however, there were fewer operational cost-cutting opportunities.
- Claire knew that WPC's selling and general administration costs were significantly higher than its competition.
- There's mounting pressure to improve the company's financial performance.

THE CONSULTANT

Claire hired Granderson Consulting to identify savings opportunities in WPC's selling and general administrative costs.

RECOMMENDATIONS

- Outsource 25% of the IT department
- Potential savings of \$5.7 million in the first year
- Total projected payback of less than four years

Savings Calculation (Granderson)		
		Total
Number of employees	110	
Annual work hours per employee	2,080	
Rate per hour	\$50	
In-house cost (annual)		\$11,440,000
Number of employees	110	
Annual work hours per employee	2,080	
Rate per hour	\$25	
Outsource cost (annual)		\$5,720,000
Total projected savings		\$520,000
Total severance costs		\$21,560,000
Projected payback		3.77 years

SEVERANCE COSTS

- Terminate 110 IT staff members
- Average of 25 years of experience
- Cost of \$196,000 per employee

Severance Cost Calculation (Granderson)		
		Total
Number of employees	110	
Annual work hours	2,080	
Average age	55	
Average annual salary	\$104,000	
Weeks pay per year of service	2	
Severance pay		\$11,000,000
Cafeteria insurance costs (annual)	\$9,600	
Annual Cost: All Employees	\$1,056,000	
Average years to Medicare (65 years)	10	
Insurance costs		\$10,560,000
Total severance costs		\$21,560,000
<i>Per employee</i>		<i>\$196,000</i>

DISCUSSION

What nonfinancial factors might contribute to a company's decision to outsource IT?

RACHAEL

- Returns after a third stint in rehab
- Reports functionally through the accounting department, while providing analytical support to the IT department
- Responsible to determine costs for IT services and to charge internal departments for those costs
- The CIO asks her to complete her own analysis of the outsourcing

RACHAEL'S FINDINGS

- Agreed with Granderson's severance cost calculations
- Disagreed with the projected savings of IT outsourcing

Revised Savings Calculation (Rachael)		
		Total
Number of employees	110	
Annual work hours per employee	2,080	
Rate per hour	\$50	
<i>In-house cost (annual)</i>		\$11,440,000
Number of employees	220	
Annual work hours per employee	2,080	
Rate per hour	\$25	
<i>Outsource cost (annual)</i>		\$11,440,000
Total projected savings		\$0
Total severance costs		\$21,560,000
<i>Projected payback</i>		<i>Never</i>

CLAIRE AND RACHAEL

- Sorority sisters
- Rachael credits Claire's support for retaining her job
- Rachael has expended all of her 401(k) accounts
- One of the IT employees is Rachael's sister, and Claire is aware of this

THEIR MEETING

- Rachael carefully explains her concerns
- Claire, irritated, responds that Granderson is never wrong
- Rachael maintains her stance
- Claire confesses she isn't completely confident in the consultant's findings, but to become CEO, she has to convince the board of directors of the findings
- Rachael, puzzled and confused, says this is wrong
- Claire states that this is the time to pay her back for saving Rachael's job so many times and offers a better job and salary for Rachael's support

THE DILEMMA

Loyalty to Claire vs. ensuring the continued employment of IT staffers, including her sister and herself

SMALL GROUP DISCUSSION

- From what points on the fraud triangle is Claire motivated to engage in this fraud?
- How do we see short-termism demonstrated in this case study?
- What options do you see for Rachael at this point?



EPILOGUE

- Rachael retired from the company
- The IT employees were terminated in the outsourcing project



COURSE MAIN TOPICS

- The fraud triangle
- Short-termism
- *IMA Statement of Ethical Professional Practice*
- To build an ethical company culture, companies should:
 - ✓ Ensure strong internal controls using the COSO Framework
 - ✓ Provide company-specific ethics training to everyone
 - ✓ Conduct annual surveys of employee attitudes
 - ✓ Establish effective whistleblowing programs
 - ✓ Expand performance incentives to include ethics-based accomplishments
 - ✓ Strategically align short-term actions with long-term goals
 - ✓ Put less emphasis on quarterly results
 - ✓ Foster robust internal and external communication
 - ✓ Commit to continuous learning





3-2-1 ACTION PLAN

3

things I learned or were reminded of in this training:

1.

2.

3.

2

things I want to do as a result of this training:

1.

2.

1

thing I'm going to do right away:

1.

BIBLIOGRAPHY

- [1] Cynthia Fornelli, "Seven Principles for Understanding and Avoiding Short-Termism," NACD Boardtalk, September 1, 2016, blog.nacdonline.org/posts/seven-principles-for-understanding-and-avoiding-short-termism.
- [2] "Fraud Triangle," Corporate Finance Institute, corporatefinanceinstitute.com/resources/knowledge/accounting/fraud-triangle/.
- [3] Steve Nguyen, "Creating an Ethical Organizational Culture," Workplace Psychology, February 14, 2011, workplacepsychology.net/2011/02/14/creating-an-ethical-organizational-culture/.
- [4] Theresa Phipps, "A Cash Cow?" *IMA Educational Case Journal*, December 2020.
- [5] Thomas G. Plante, "Six Ways to Create a Culture of Ethics in Any Organization," *Psychology Today*, July 1, 2015, www.psychologytoday.com/us/blog/do-the-right-thing/201507/six-ways-create-culture-ethics-in-any-organization.
- [6] Robert Rankin and Trish Driskill, "Troubled Waters: An Outsourced Ethical Dilemma," *IMA Educational Case Journal*, June 2020.
- [7] Curtis C. Verschoor, "Ethical Culture Moves to Center Stage," *Strategic Finance*, January 2018, sfmagazine.com/post-entry/january-2018-ethical-culture-moves-to-center-stage/.
- [8] Curtis C. Verschoor, "Overcoming the Fraud Triangle," *Strategic Finance*, June 2015, sfmagazine.com/post-entry/june-2015-overcoming-the-fraud-triangle/.
- [9] Curtis C. Verschoor, "Striking Jump in Business Fraud and Crime," *Strategic Finance*, June 2018, sfmagazine.com/post-entry/june-2018-striking-jump-in-business-fraud-and-crime/.
- [10] "What is short-termism? Definition and meaning," MBN Market Business News, marketbusinessnews.com/financial-glossary/short-termism-definition-meaning/.



The Association of
Accountants and
Financial Professionals
in Business

ACKNOWLEDGMENTS

Presentation produced by: Ignite It Group (www.igniteitgroup.com)



CONTACT US

For more information about this or other programs, please contact IMA.

www.imanet.org

10 Paragon Drive, Suite 1, Montvale, New Jersey 07645-1760

US (800) 638-4427 or International +1 (201) 573-9000

Copyright © 2021 IMA® (Institute of Management Accountants). All rights reserved.