An Instructional Case For Courses In Financial Accounting, Auditing, Managerial Accounting, Ethics, And Fraud Examination

Thomas Brady, Ph.D., University of Dayton, USA

Ron Burrows, Ph.D., University of Dayton, USA

**ABSTRACT**

*This case study describes an account in which a student run business venture at a university faces the prospect of loosing control of a segment (Café) of its business due to the impending reporting of an operating loss in the current period. The CEO is adamant that the financial statements must not reflect a loss and suggests ways in which the CFO might make this happen. While the case is set in an environment that is familiar to most students it can serve as a vehicle for the examination of the broader real world issues relating to inappropriate operating and accounting choices which lead to the practice of earnings manipulation or possibly intentional fraud. Students have the opportunity to (a) identify the key stakeholders, (b) comment on the operational, accounting, and ethical issues raised by the case, (c) examine relevant accounting standards related issues (d) reason out alternative courses of action with respect to the facts of the case and (e) propose a course of action to resolve the problem(s) and defend it in either a written submission or in class discussions. This case can serve as an excellent tool for a deeper level of instruction, at various levels in an accounting program, about the critical role of accounting in the economy and in society.*

**Keywords:** Accounting Fraud; Auditing; Ethics; Instructional Case

**INTRODUCTION**

A

 general recurring theme for many accounting educators is how to develop an optimal strategy for delivery of accounting concepts in their courses. Many accounting teachers seek to develop a strategy that will nurture something different and move students away from simply focusing on the facts and figures to a focus on a deeper learning that is more holistic. As educators, they seek to produce learned professionals capable of responding to the fast changing social and work environment in which accountants must function. Such students would have the ability to globally represent accounting problems, relate new information to old, develop high quality inferences and exhibit integrated high quality solutions.

This paper proposes that the use of active learning strategies utilizing the case or problem solving approach is one way to (1) help accounting students to process accounting course material and related concepts by providing a framework in which they use practical thinking skills, (2) gain appreciation for the societal role of the accounting profession, (3) develop skill in the application of accounting principles, (4) help develop their eagerness to become life-long learners in terms of their accounting knowledge and (5) aid instructors in the measurement and articulation of what student are learning. While such active learning strategies can lead to a deeper understanding of course concepts they are not intended to supplant, but to supplement more traditional techniques such as lectures, readings and class discussions.

**STUDENT ENTERPRISES-BACKGROUND**

Student Enterprises (SE) is a student-run business venture at Midwest University (MU) in a major city in America’s heartland. SE receives financial support from the College of Business (CoB), the Department of Student Development, the Provost’s Office, and the central administration of MU. SE currently includes six business segments: two mini convenience stores, two coffee/drink shops, a café, and small clothing/souvenir shop. It operates as a holding company, with finances pooled at the corporate level and operations coordinated by an executive team. The Board of Directors (faculty, administrators and an Executive in Residence) provides guidance and has ultimate decision-making authority and grants authority to the Chief Executive Officer (CEO) as it sees fit, although MU retains final authority over major decisions and relationships. Officers of the company (all students) include the CEO, the Chief Financial Officer (CFO), and division Vice-Presidents/Chief Operating Officers (VP/COO). SE has a June 30th year-end so as to roughly correspond with the end of the school year at MU.

Barry Jones is the present CEO. He is a senior business major who has worked for SE all throughout his college career. He has worked in the convenience stores his first two years in school. In his junior year he was promoted to VP/COO of the convenience stores division before being named CEO in his senior year. Barry is a very good student, very sure of himself, and already has a great job lined up after his graduation in June. Sara Jones, the CFO, is also a senior and an accounting major who is planning on staying for a fifth year MBA graduate program in order to meet CPA exam eligibility requirements. She had been promoted to CFO from VP-Accounting as of January 1 of 2012. The previous CFO, Scott, graduated in December of 2011 and took a job with a big four accounting firm. Sara intends to be CFO the rest of 2012 and all of the 2013 fiscal year. She too hopes to work for a big public accounting firm after graduation.

**Actions in March 2012**

The following conversation took place in early March of 2012 between Barry and Sara:

**Barry:** As you know, we have a June 30 year end and you, as CFO, have the responsibility to prepare our financial statements at that time.

**Sara:** Yes, I realize that. Exactly how are our financial statements used around here anyway?

**Barry:** They’re mostly just for show. The Board of Directors expects to see them but only gives them a quick glance. Sometimes the CoB will use our program and results to try to impress possible donors to attract more money or for prospective students and their families to get them to come here. Otherwise, I’m not sure what they are used for since nobody has made a big deal about them.

**Barry** continued: On an overall basis SE is doing pretty well this year and our general financial information shouldn’t look too bad. However, we do have some potential problems that we have to watch out for. While you are familiar with our Convenience Stores and Coffee Shops since you have worked in them, you may not know as much about the Café, one place we might have a problem. The University put up $300,000 to develop the Café. It didn’t cost SE a dime. We signed a contract stipulating that we would manage the Café and split the profits 49% for us and 51% to the University. The Café opened in the fall of the 2002-2003 school year. Therefore, this is its tenth year of operation. The problem is there has never been a profit at the Café. There is a provision in the contract that calls for the management of the Café to revert to the University if the Café loses over $25,000 in any one year or any amount for three years in a row. The good news is that we’ve never lost anything close to $25,000. The bad news is that the Café has lost money the last two years and it looks like it is headed for a loss again this year.

**Sara:** Which is a problem because that would mean the University would take the Café away from SE.

**Barry:** And if that happens, you and I both look pretty stupid. I’m graduating soon and already have a nice job lined up. I don’t know if this would cost me my job. I sure hope not. I have about a zillion dollars of student loans to pay back. Do you have a job for after graduation?

**Sara:** No, I’m in the five-year MBA program so I have another year of school. I am hoping to go to work for a big four accounting firm someday and having this on my record certainly wouldn’t look good to the recruiters.

**Barry:** I don’t want us to lose the Café while I’m CEO. That would be at least very embarrassing and could possibly hurt our career plans. But, you know what? There is more bad news. $15,000 worth of CoB scholarships are tied to us managing the Café. As long as we have the Café the CoB hands out scholarships to business students in the name of Student Enterprises. If we lose the Café, we lose the scholarships and a great learning opportunity for future students.

**Sara:** Well, aren’t you just full of good news?

**Barry:** The losses the last two years have been fairly small. I’m not sure where we stand this year, but I don’t think it’s too bad. I don’t think it’s so bad that you can’t fix it. You have to fix it! I don’t remember that much accounting, but you’re a smart accountant aren’t you? There must be something you can do between now and the end of June to make sure the Café doesn’t show a loss for the fiscal year. Aren’t there perfectly legal ways to use different accounting methods to make financial statements look better?

We just can’t let the Café show a loss again this year. Scott assured me that you could handle this job. Was he wrong?

**Sara:** I can handle it. I’ve got three exams next week, but after that I’ll go look at the Café’s operations and how they are accounted for and see what I can do. I’ll get back to you in a couple of weeks.

**Barry:** Thanks, Sara. Isn’t it great how our professors always schedule exams at the same time? I think they get in a room with the Student Activities Calendar and find the times that are most inconvenient for the most students.

We’ve got to find a way for the Café to show a profit this year. You’re the accounting expert, so it’s up to you to make it happen.

**Follow-up in April 2012**

About one month later the CEO and CFO meet again:

**Barry:** Sara, please give me some good news.

**Sara:** Well, I’ve become very familiar with the operations of the Café since our last meeting. It appears that the past SE consolidated financial statements were prepared using modified cash-accrual accounting concepts. Also, based on my best estimate the Café appears headed for a loss of about $5,000 this year. I was able to improve the situation a little by cutting back on the number of servers we use at the Café and by delaying the purchase of some food items and supplies until after June 30. However, I don’t see other alternatives to wipe out the whole amount of the loss. It looks like there’s going to be at least a $2,000 to $2,500 loss. Have you spoken to any accounting faculty member or anyone on the Board about the situation?

**Barry:** No, I have not talked to anyone; this is just between the two of us. As I told you before, we can’t let that happen. Having the University take over the Café on my watch is simply not an option! It’s totally unacceptable! I’ve had a great record here and I don’t want that messed up. I may be able to help you. Last summer I went to a meeting attended by CEOs and CFOs of student-run businesses from several universities from across the US. During the three days I was there, I became pretty good friends with two CEOs in particular. Well, last week I gave them both a call to see if they ever had a problem like this and to ask for advice. Based on what they told me, it seems that the University shafted us when they made us sign the management contract for the Café. Nobody else has such severe penalties as a result of small losses in one area of the businesses they run. My friends gave me some suggestions of ways we might get out of this situation. I’ve typed them up and added a couple of my own ideas. Here is the list. (See attached list) Frankly, I wouldn’t feel badly about doing any of these things. Everybody at SE works too hard to have a small loss at the Café, which can’t possibly be relevant to anything given the size of the university, put a black mark on our records. It’s just not fair when Student Enterprises as a whole is profitable.

**Sara:** Based on a quick look at your list, I have concerns about some of the proposed solutions.

**Barry:** You have to fix the numbers!! I know that Scott would have taken care of it. He told me you could be trusted to be a team player. Go fix the numbers so that the Café shows a small profit.

## List of Barry’s Possible “Solutions” to the Café Problem

* Shift revenues from other SE businesses to the Café. (“Excess” sales at the Coffee Shops or Convenience Stores)
* Delay recognition of some Café expenses or allocate some expenses from the Café to other SE business segments.
* Use employees (or inventory) of the Convenience Stores or Coffee Shops at the Café. Charge the related expenses (Cost of Sales) to the other SE businesses.
* Promote the Café by distributing Coupons at other SE businesses that allow for discounts at the Café. (Record revenue for Café but charge the discounts to the other lines of business).
* In conjunction with number 4: Record the sales at the Café at full pre-discount amounts and record the discount as an “intangible asset”. Can’t this be considered an asset because the new customers will often turn into repeat customers and that will benefit future sales.
* An “intangible asset” for “start-up costs” could be set up to equal or exceed the loss that otherwise would be incurred. Most businesses expect to incur losses in the first few years. If it is “expected” and “normal” and it helps the business get off the ground, then it is only fair to record it as an asset and not a loss.
* Just do something, allocate fixed or other expenses away from the Cafe or change the numbers to make them come out. Nobody will ever know!

**CONSIDERATIONS FOR ANALYSIS** **& POSSIBLE DISCUSSION POINTS:**

* What are the key facts in this case?
* Who are the key stakeholders?
* What should be the guiding principles in running SE?
* What is the relationship between personal goals and ambitions and duties and responsibilities to the organization?
* What are some legitimate operational actions that might be undertaken in an effort to improve the financial situation at the Café?
* How might suggested actions on Barry’s list lead to falsification or manipulation of financial reporting information?
* What do you think of the Barry’s assertion that the financials are “just for show” from an “accounting perspective” and a strategic business perspective?
* What do you suggest to help ensure appropriate ethical behavior?
* What do you suggest so that the financial statements are useful, relevant, fairly presented, reliable, and in accordance with accounting guidelines?
* What do you suggest in the short run, and over the long run, to help with the “Café problem”?
* What should Sarah do?

**SUGGESTED DISCUSSION POINTS**

**Possible Ethical Issues/Considerations:**

Misrepresentation of facts; changing data; bias; fraud, results at any cost attitude; pressure to do wrong. What do professional ethical standards require in this case? What are the responsibilities to stakeholders? Can small ethical missteps be OK so that the “larger good” can be served? Is there any connection to Professional Accounting Code of Conduct or a Student Code of Conduct at the school? Might, as Barry suggests, the MU-SE contract be an “unfair” arrangement? Why?

**Possible Financial Reporting Issues/Considerations:**

Characteristics of Useful financial reports; Qualities of useful information; Issues relating to proper matching of revenue and expenses; Quality of Earnings issues; Requirements of Student and or Professional Codes of Conduct; AICPA Guidelines. Internal Control and governance role of the Board of Directors in setting the ethical “tone at the top”?

**Individual Related Considerations:**

* Would you want to work for a boss like Barry? Why or Why not?
* Does Barry demonstrate a high commitment to organizational and personal integrity? Why or Why not?
* What organizational conditions or personal characteristics do you believe give rise to what appears to be Barry’s willingness to do “whatever it takes” to meet business targets?
* What do you think are the most appropriate values that Barry should apply to his decisions and behaviors?
* Would you be willing to hire Barry? Why or Why not?
* What should Sarah do? What are her options?
* How should Sarah respond to the pressures being exerted by Barry?
* What is the “right thing” to do? Should she approach a faculty member or a Board of Directors member?
* Does Sarah’s aspiration to become an accountant imply or attach a higher standard of conduct to her behavior.
* Would you be willing to hire Sarah? Why or Why not?

**POSSIBLE REQUIRED CASE ANALYSIS ACTIONS**

Prepare a typed written analysis of this case. Use appropriate professional grammar, sentence structure, spelling and organization. Be specific.

* Describe the case situation accurately & outline the relevant facts
* Identify any ethical issues involved
* Determine who – individual & group stakeholders – are affected and how.
* Identify rights and responsibilities of each party
* Identify the legitimate alternative courses of action available to the Barry and Sara.
* Identify the possible consequences of each alternative on each stakeholder
* Evaluate each alternative in terms of the rights and responsibilities of each party
* Identify the environmental factors which encourage/discourage financial statement manipulation.
* Decide on an appropriate course of action.
* Explain why you selected that particular course of action.

**TEACHING NOTES, POSSIBLE DISCUSSION ITEMS & INSTRUCTOR ROLE**

While the setting of the Student Enterprises (SE) case is related to a campus based student run business the issues involved are loosely based on those encountered by a number of multinational corporations which have been involved in some of the largest bankruptcies in recent years. The instructor could provide and/or students might be required to review some of the major US and international accounting lapses of the past in order to gain a historical perspective (for example: Enron-USA; Tyco Intl-Bermuda; Nortel-Canada; Anglo Irish Bank-Ireland, just to name a few).

Use of a mythical student-run business as the setting for the case is intended to enable students to better relate to the issues portrayed in the case.

For those students who are or who aspire to be accounting majors, the case is intended to convey the lesson that a strong ethical commitment, a tone of professionalism and appropriate selection among accounting alternatives is essential for the practice of accounting. The case also requires students to step back from the process of simply recording financial transactions and examine the bigger picture related to potential issues relating to how the numbers are developed. Additionally, for those who are not accounting majors the lessons of the case should help in understanding the sometimes subjective nature of what accountants do, how and why they make decisions, the ethical considerations relating to accounting choices and the business impacts of accounting decisions.

Potential stakeholders in the SE case include:

* Barry, the CEO
* Sarah, the CFO
* Future employers of Barry & Sarah.
* Student employees of SE, in particular those working at the Café.
* Students currently receiving SE related scholarship aid.
* Future students applying for SE employment and related scholarship aid.
* The university (MU)
* Members of the SE Board of Directors
* Users of SE Financial Statements
* Accounting Regulatory Agencies (SEC, FASB)

While there is no ideal approach to the uses of cases in the accounting curriculum, instructors might consider the following general factors when using the case method.

* Use of the case method requires a high level of preparation on the part of the instructor....*know the essential facts of the case.*
* Guide the discussion by asking leading, but limited numbers of questions. This is not to say that the instructor should seek to control what participants say, but hopefully to move the process toward accomplishment of the case learning objectives.
* Minimize comments which might indicate your opinion as to the “correct” answer to the case, but instead encourage students to respond to other student comments.
* Listen carefully, encourage all students to participate and try to keep the discussion “on topic”.
* Have students summarize the case discussion and identify the proposed alternative courses of action and any conclusions reached.

While the role of the instructor is critical, it is also important to understand that successful use of the case method is also heavily dependent upon the full involvement and level of preparedness of the students. The setting should be one in which students feel encouraged to participate in the discussions while expressing their opinions in a respectful and professional manner without monopolizing the conversation.

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**AUTHORS’ INFORMATION**

**Tom Brady**, Ph.D., is an Associate Professor in the Accounting Department, University of Dayton, USA His teaching interests are in the area of Financial Accounting and his research focus is in the areas of Financial, IFERS-GAAP convergence and teaching strategies in the accounting curriculum. E-mail: TBrady1@UDayton.edu (Corresponding author)

**Ron Burrows**, Ph.D.,is an Associate Professor and former Chair of the Accounting Department. His teaching and research focus are in the area of Financial Accounting and the role of ethics in accounting education. Ron Burrows, Ph.D.,University of Dayton USA. E-mail: ron.burrows@notes.udayton.edu