**Case 2-6**

Supreme Designs, Inc.

Supreme Designs, Inc., is a small manufacturing company located in Detroit, Michigan. There are three stockholders of the company—Gary Hoffman, Ed Webber, and John Sullivan. Hoffman manages the business including the responsibility for the financial statements. Webber and Sullivan do most of the sales work, and they cultivate potential customers for Supreme Designs.

Hoffman recently hired his daughter, Janet, to manage the office. Janet has successfully managed a small clothing boutique in downtown Detroit for the past eight years. She sold the shop to a regional department store that wanted to expand its operations. Gary Hoffman hopes that his daughter will take over as an owner in a few years when he reaches retirement age. Webber and Sullivan are significantly younger than Gary Hoffman.

Janet is given complete control over the payroll, and she approves disbursements, signs checks, and reconciles the general ledger cash account to the bank statement balance. Previously, the bookkeeper was the only employee with such authority. However, the bookkeeper recently left the company, and Hoffman needed someone he could trust to be in charge of these sensitive operations. He did ask his daughter to hire someone as soon as possible to help with these and other accounting functions. Janet hired Kevin Greenberg shortly thereafter, based on a friend’s recommendation. Greenberg is a relatively inexperienced accountant but he was willing to work for less than what the company had paid the former bookkeeper.

On April 29, 2014, about one year after hiring Greenberg, Janet discovers that she needs surgery. Even though the procedure is fairly common and the risks are minimal, she plans on spending five weeks in recovery because of related medical problems that could flare up if she returns to work too soon. She tells Greenberg to approve vouchers for payment and present them to her father during this time, and her father will write the checks during her absence. Janet had previously discussed this plan with her father and they both agreed that Greenberg was ready to assume the additional responsibilities. They did not, however, discuss the matter with either Webber or Sullivan.

The bank statement for April arrives on May 3, 2014. Janet did not tell Greenberg to reconcile the bank statements. In fact, she specifically told him to just put those aside until she returns. However, Greenberg decides to reconcile the April bank statement as a favor to Janet and to lighten her workload after she returns.

Although everything appears to be in order, Greenberg is not sure what to make of his finding that Janet approved and signed five checks payable to herself for the same amount during April 2014. Each check appears in correct numerical sequence, 1 check of every 10 checks written during the month. Greenberg was surprised because if these were payroll checks (as he had suspected because they were for the same amount), it was highly unusual. This is because the payroll is processed once a month for all employees of Supreme Designs. In fact, he found only one canceled check for each of the other employees including himself.

Curiosity gets the better of Greenberg and he decides to trace the checks paid to Janet to the cash disbursements journal. He looked for supporting documentation but couldn’t find any. He noticed that four of the five checks were coded to different accounts including supplies, travel and entertainment, books and magazines, and two to miscellaneous expenses.

After considering what his findings might mean and whether he should contact Janet, Greenberg decided to expand his search. He reviewed the bank statements for January through March of 2014. In all, there were 15 additional checks made payable to Janet, each for the same amount as the 5 in April. These 20 checks totaled $30,000. Greenberg still thought it was possible these amounts represented Janet’s salary because he knows her annual salary is $50,000. Perhaps she took out a little more this year.

Greenberg doesn’t know what to do. He could contact Janet, but he knows she would be unhappy that he opened the bank statements and went so far as to reconcile cash for April even though she specifically told him not to do it. Perhaps he should contact the three stockholders. Then again, it may be best if he keeps quiet about the entire matter.

**NOTES**

Because the manager of a small business has made checks out to herself on a regular and routine basis suggests that the possibility of material irregularities exist in this case. The case is further complicated by the fact that the manager is the daughter of one of the owner of the business. Misappropriation of resources is the primary issue of this case. The ethical dilemma is presented from the point of view of Kevin Greenberg, the young accountant who discovers the irregularity.

Instructors may want to extend the discussion in this case and provide some information to the students on the existence and cost of fraud to global business. The Association of Certified Fraud Examiners puts out a Report to the Nation in even numbered years. The summary of the 2012 Report to the Nation is discussed in chapter 3.

**Ethical Issues**

The financial statements of Supreme Designs for the current year will be materially misstated if corrective action is not taken, assuming that Janet Hoffman has written the improper checks all year long. The misappropriation of funds by Janet Hoffman seems to constitute an illegal act. Additional information may be needed in order to make this determination with certainty because it appears that Hoffman has the authority to do almost anything that she wants. Nevertheless, the seriousness of the act raises concerns about the integrity of management and reliability of internal controls. The latter clearly are inadequate because there is no separation of duties, a critical component of internal control, in that one person, Janet Hoffman, performs both the disbursement function and the reconciliation of the bank statement with the general ledger cash account.

This case deals with the basic issue of honesty. Janet Hoffman has engaged in a dishonest act by fraudulently writing checks that are payable to herself. Consequently, she has violated the trust placed in her by her father. Kevin Greenberg becomes involved because he assumed some of Janet’s responsibilities while she was hospitalized. Greenberg seems to know what the right thing to do is, but he may feel constrained by the fact that he reports to Janet and Janet gave him strict instructions what to do and what not to do and Greenberg did not follow them.

Greenberg owes his ultimate allegiance to the owners of Supreme Designs. Janet is not an owner. It is her father that is part owner of the business. Greenberg should consider how Gary Hoffman might feel about knowing that his trusted daughter has stolen from the company. He has a right to be informed about this, and the other owners should know as well.

**What Actually Happened**

Greenberg disclosed his findings to Gary Hoffman who did not believe him at first. A meeting was called of all the owners. Eventually, Hoffman was persuaded to accept what happened because of the convincing evidence presented by Greenberg, and he fired his daughter. Years later it was discovered that Gary Hoffman was selling miscellaneous inventory and company equipment that had little or no value on the books. This created a great deal of tension between the owners. In discussions with Janet Hoffman it was determined that she felt justified in her actions because she knew that her father had engaged in similar activities.

**Questions**

**1. Do you think Greenberg did the “right” thing by opening the April bank statement and reconciling it to the general ledger? Why or why not? What about the previous bank statements?**

Kevin was not authorized to open the bank statement and reconcile it to the general ledger. He had good intentions and had lucky results. Ask students what they think would have happened if Kevin opened the bank statement and had not found misappropriations by Janet. From an ethical perspective, he violated the trust Janet placed in him. Here, the ends do not justify the means.

**2. Explain what Greenberg should do if he reasons at each of the six stages of Kohlberg’s model of moral development. Be sure to consider stakeholder effects in your answer.**

Kevin is first faced with the fact that he cannot tell anyone without first admitting that he disobeyed his instructions. Stage 1: Kevin would stay quiet as speaking up will cause trouble. Stage 2: Kevin would tell the partners with the hope he will somehow be rewarded for his actions. Stage 3: Kevin might stay quiet as to protect Janet and the possible negative effects for the company of the fraudulent actions of Janet. Stage 4: Kevin knows Janet has violated GAAP rules and the laws and would step forward to inform others about it; the manner of doing so may be determined by whether he is at stage 5 or 6. Stage 5: Kevin weighs the harms and benefits; considers stakeholder needs; and he either goes to Janet for an explanation and, perhaps, corrective action, or takes the matter directly to Janet’s father, or takes it to all of the owners. Stage 6: Kevin goes to all the owners because each one has a right to know what has happened.

**3. Evaluate what steps should be taken in each of the following independent situations:**

**a. If you were Janet and Greenberg dropped by the hospital to tell you about his discovery, how would you react?**

Janet may consider the following actions once Kevin tells her he knows about the misappropriations: 1) fire him so he cannot tell without looking like a disgruntled employee motivated by revenge; 2) try to spin Janet’s explanation in a way that pressures Kevin to accept that the checks are legitimate; or 3) ask or threaten him not to tell so she can make it right and turn herself in once out of the hospital.

**b. Assume Greenberg contacts Janet’s father because he did not want to upset her after the surgery. Hoffman talks to his daughter, who informs him that she had a shortage in her personal funds and planned to repay the $30,000 after she returns. What would you do if you were Gary Hoffman? Why?**

Gary may want to give Janet a chance to reform herself. Gary may plan to pay the money back to the company so the partners do not find out. Gary owes an obligation to his partners but he also has loyalty to his daughter.

In the short run, Gary may help his daughter by covering her losses. In the long run, he isn’t teaching her right from wrong and it may affect her actions negatively down the road. The harder and ethical thing to do beyond that is to remove Janet from the firm.

c. **Assume Hoffman does nothing because of his daughter’s explanation. Janet returns to work and fires Kevin Greenberg. What would you do if you were Greenberg. Why? How do you think his action (or inaction) might affect his opportunity for other jobs? Should that matter in terms of what he decides to do?**

Kevin’s choices are narrowed. Having been fired, if he tells anyone about the incident he may not be believed and it may limit his chances of getting another job. Hopefully Kevin documented all that happened and all that he’s done in the situation before or right after he was fired. Once he has secured another job, Kevin can consider whether he should report the situation to the other partners, to the police or to the press.