Institute for Christian Teaching
Department of Education of Seventh-day Adventists

CASE STUDIES IN ACCOUNTING FRAUD: WHAT WOULD JESUS DO? INTEGRATING ETHICS AND VALUES IN ACCOUNTING COURSES

Carmelita Troy
Andrews University
Berrien Springs, Michigan, U.S.A.
troyc@andrews.edu

752-16 Institute for Christian Teaching
12501 Old Columbia Pike
Silver Spring, MD 20904 USA

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Purpose/Objective

The purpose of this essay is to address ethics from a Christian-values perspective through case studies. The three case studies are real-life companies that were subject to enforcement action by the U.S. Securities and Exchange Commission for accounting violations. Each case requires an analysis of an accounting principle and the ethical principle(s) involved when that accounting principle is breached. The case questions require the student to [1] analyze the fraudulent accounting activities of a company and [2] evaluate alternative courses of action that are consistent with and based on Christian principles – in other words, based on "What would Jesus have done?" Each case should help the student better understand the ethical dilemmas related to accounting and financial reporting that managers, executives, and lower level staff sometimes face. The intention of each case is to help the student [1] better understand an accounting principle by examining a situation where the principle was deliberately violated and [2] discuss what Biblical principles a Christian would/should have followed to guide decision making processes.

Introduction

For most of the last decade incidences of accounting fraud have made headlines in the popular press and have been examined by the academic community. Investors, creditors and others relying on the financial statements, made decisions based on faulty, if not downright falsified, financial information. The consequences to these parties, external to the corporation, can be severe: often they are left with investments that have lost much, most, or all of their value, once the fraud is discovered.

Accounting fraud, by its nature involves failure of the system of record-keeping and reporting in a business. It is unclear why would individuals go to great lengths, often breaking the law in addition to violating accounting standards, in order to manipulate the financial reports and deceive those relying on the financial statements. Blame has at times been placed at the feet of those educating and training the business leaders and accountants who commit these dastardly acts. Business schools, partly as a consequence, have augmented their programs to more explicitly include modules or courses in business ethics.

Incorporating ethics in accounting courses has particular challenges. Accounting faculty often point out that they are not qualified to teach ethics or that the quantity of accounting material that has to be covered leaves little time to address ethics in a meaningful way. A faculty member who takes the time to discuss ethical scenarios in an accounting class, I believe does so with the hope that if in future a student finds himself or herself facing an ethical challenge relating to financial reporting, he/she would recall something the ethics discussion and make a better, "more ethical" decision, as a result.

Ethical Perspectives

Two of the more widely known ethical perspectives are deontological[1] and teleological.[2] The deontological perspective is based on doing what is right or what is good and doing so regardless of the consequences...whether favorable or unfavorable. Teleological ethics is results-focused. So the teleological approach weighs the consequences of an action to determine whether an action is the ethically-correct posture to take.

Much of what is propounded in the Bible seems to favor the deontological approach rather than the teleological approach, though examples of consequence-based decision-making do exist and apparently were blessed.[3] Duty-based ethics are codified in the 10 commandments. Jesus summarized our responsibilities in two duties – first our duty to God - to love Him fully and completely and then our duty to our fellow-man - to love your neighbor as you love yourself.[4] The logical follow-on question to "Who is my neighbor?" is what does this duty oblige me to do?

The Jewish Rabbis and teachers attempted to interpret the Biblical law into required behaviors for every conceivable circumstance and to codify all of a person's duties and responsibilities. Harkness[5] notes that Jesus did no such thing. Rather our duties and responsibilities (our Christian ethics) are based on broad principles. The sixth commandment enjoins us from killing or murdering another person and the New Testament broadens our understanding by expanding upon this commandment – "whoever hates his brother is a murderer."[6]

The Old Testament, more so than the New Testament, illustrates unacceptable behaviors relating to the conduct of business. In Leviticus 19:36 God commands the use of "honest scales and honest weights, an honest ephah and an honest hin" and in Amos 8:5, 6 He condemns the Israelites for "making the ephah small and the shekel large, falsifying the scales by deceit...even sell[ing] the bad wheat." Exodus 23:8 and Job 36:18 instruct against accepting bribes, because the bribe perverts justice.

The eighth commandment states "Thou shall not steal." The intention of this commandment can be interpreted to refer to both stealing directly from another or indirectly.[7] Indirect theft occurs through overcharging a customer or by misleading in order to direct benefits to one's self that are not deserved. For example, a company executive who overstates earnings and as a result receives a bigger bonus, he/she is stealing...taking that which is not deserved. Deliberately failing to pay just debts is another form of theft. In Malachi 3:5 those who defraud laborers of

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[1] See, for example, http://plato.stanford.edu/entries/ethics-deontological/.

[2] See, for example, http://www.ethicsandbusiness.org/strat1.htm

[3]For example, the story of Rahab, who lied to the officials of her city about where the Israelite spies were. Based on the 10-commandments what she did was wrong, but the consequences of telling the truth would have meant, barring divine intervention, certain death to the two spies she was sheltering.

[4] See Matthew 23, Mark 12 and Luke 10.

[5] Harkness, Georgia. 1957. *Christian Ethics.* Nashville: Abingdon Press.
http://www.religion-online.org/showchapter.asp?title=802&C=1083

[6] 1 John 3:15

[7] Jesus uses a similar train of thought when He stated that adultery occurred not just physically, but in one's *mind as* well. (see Matthew 5:28)

their just remuneration are condemned and Romans 13:8 directs us to leave no debt obligation outstanding.

These ethical guidelines and all others in the Bible can be summed up in the second commandment of Jesus, to love your neighbor as yourself, and in the Golden Rule of Matthew 7:12, "whatever you want men to do to you, do also to them." Thus from a deontological point of view, the Christian ethic, based on Biblical principles, informs us of what is the better alternative, regardless of the consequences to us personally. And Biblical principles can and should be used to guide in the ethical dilemmas faced in the workplace today.

The purpose of these discussion cases is for the student (either individually or in a small group) to analyze improper accounting from a documented case of accounting fraud,[8] by first focusing on the accounting/business principles that were circumvented. Then the student is challenged to think about the ethical or Biblical principles that were not upheld and discuss what a Christian should do or what would Jesus have done under the circumstances. The case documents are from the U.S. Securities & Exchange Commission's (SEC's) enforcement division.

The Securities & Exchange Commission (SEC)[9]

After the crash of the U.S. stock market in 1929, the faith of the investing public in the stock market was at a low. Congress passed legislation, the 1933 and 1934 Securities Exchange Acts, establishing the SEC. The primary intention of the legislation was to increase stockholder confidence in the capital markets. The SEC was to do this through its mission "to protect investors, [and] maintain fair, orderly, and efficient markets."

Currently, the SEC is comprised of four divisions (Corporation Finance, Enforcement, Investment Management and Trading & Securities) and a large number of offices, including the office of the General Counsel and the office of the Administrative Law Judges. It is the Division of Enforcement that that is responsible for investigating violations of securities law (including accounting fraud). Based on the results of its investigations, the SEC can bring administrative proceedings against or prosecute companies or individuals civilly or criminally. Civil suits relating to securities laws can be prosecuted in the federal courts or in the SEC itself, in front of Administrative Law Judges. The SEC works closely with law enforcement agencies, including the Department of Justice in the U.S. and other international bodies to prosecute criminal cases in federal court. While prosecutions are public, SEC investigations are "conducted privately" in part to prevent spooking the market.[10]

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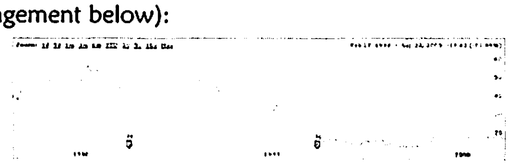
[8] These cases are of U.S. companies that violated U.S. Generally Accepted Accounting Principles and SEC regulations. In selecting these two examples, I have a company where the accounting fraud also violated IFRS (International Financial Reporting Standards) and another company where the issue was related to bribes and corrupt practices. In this way the cases are useful to an international audience.

[9] http://www.sec.gov/about/whatwedo.shtml#org

[10] Typical of what can happen to stock prices when word of an SEC investigation or accounting fraud is leaked (as is shown in the graph of Waste Management below):



Using SEC enforcement actions as the basis for case studies is beneficial primarily because the SEC has done a thorough investigation that has resulted in the respondent(s) consenting to the SEC sanctions (often "without admitting or denying the charges") or with a judgment in a criminal case where the defendants have either pled guilty or were found guilty of the charges against them. The SEC enforcement actions provide a complete description and documentation of the fraudulent activities and explain how securities law and accounting regulations were not followed. All the SEC documents are publicly available online at the SEC website with the links to the documents for each case provided.[11] With much of the accounting and business information provided, the instructor can focus more on the ethical issues when discussing the case.

The remainder of this paper consists of the three cases. [12] First I summarize each case for the instructor and give the links to the source material from the SEC. This is followed by a series of questions relating to the accounting principles, with recommended solutions. Finally, questions connected to ethics and Bible-based values are listed with suggested responses. The cases for distribution to the students are included in the appendices.[13]

Case #1 - Minuteman International, Inc[14]

Minuteman International Inc produces "commercial, industrial, and chemical cleaning products." According to Hoovers, "janitors with wood-handle mops and tin buckets dream about Minuteman International"[15] and its quality floor and carpet care products, cleaning chemicals, carpet sweepers, scrubbers, and the like.

The company was founded in 1951 as the American Cleaning Equipment Corporation and is currently headquartered in Addison, Illinois USA. At the time of the events of this case the company was a publicly traded company. But in 2004 Minuteman was purchased by Hako-Werke International, a German company, and was taken private.

According to the SEC during 1989 to mid-2001, and perhaps earlier, the company improperly recorded revenues by keeping the books open at the end of the quarter. MII recorded as revenues on the last day of the previous quarter sales that were actually made during the first few days of the new quarter ("post-period sales").

Minuteman's reasons for keeping the books open appear to have less to do with overstating earnings than is usually the case.[16] The reason for the fraud, documented in the SEC documents

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[11] The SEC documents, used in these three cases, have also been uploaded onto the website: http://groups.google.com/group/sec-enforcement-actions

[12] A comprehensive list of published SEC enforcement actions for faculty interested in developing their own cases is available at http://www.sec.gov/divisions/enforce/friactions.shtml.

[13] Faculty using the cases should feel free to adapt the questions to meet their teaching needs. Acknowledgement, however, would be appreciated.

[14] Please see Appendix #1 for a suggested handout for students. As an assignment for an upper-division accounting course, I suggest that the general information about the company would be included in the handout and the student would be required to research and describe the company's fraudulent activities.

[15] http://www.hoovers.com/minuteman-international/--ID__13630--/free-co-profile.xhtml

[16] Often the reason given (if not the most frequently cited) for overstating earnings is for the company to meet external or internal revenue or profit targets. This, by necessity, means that earnings for the year would need to be reported at greater than what they actually were. In Minuteman's case the annual earnings were NOT overstated.

seems in part to be based on commission system for payments to the company's salesmen.[17] Commissions were paid on a monthly basis; however there were also quarterly and annual bonuses that were paid if the salesmen met the quarterly and annual sales targets. By keeping the books open at the end of the quarter some salesmen, that otherwise would have not qualified for a quarterly bonus, were able to receive a quarterly bonus. The overstatements occurred only during the first three quarters of a fiscal year. The SEC document ¶6, states that "the practice was not followed at year-end." In fact, the 4th quarter/annual earnings were understated in order to report revenues and profits accurately for the fiscal year.

For the nine quarters that the SEC documented earnings overstatements the revenues were overstated between $195,000 and $1,356,000 per quarter (up to 5.9% of revenues) and the net income was overstated by between $43,000 and $268,000 or overstated by up to 23.8%. The company discontinued the practice in mid-2001 after the SEC notified the company that it was under investigation for its revenue recognition practices.

Case Information Sources

SEC Administrative Proceeding against Minuteman, http://www.sec.gov/litigation/admin/34-47894.htm

Company website, http://www.minutemanintl.com/

Accounting Violation Questions and Suggested Solutions

1. Briefly describe the conditions that must be met in order for a company to record revenue on its books (i.e., the revenue recognition principle).

   Revenue should be recorded only after the following two conditions have been met:

   i. *The revenue has been earned – that is, the party providing the good or the service has completed all (or virtually all) that it is required to do in accord with the sale.*

   ii. *The cash (selling price) has been received or is receivable. The latter referring to having an IOU from the customer that is considered to be "good".*

2. According to the SEC, Minuteman improperly reported its quarterly revenues during 1989 to 2001.

   a. Describe Minuteman's revenue recognition practices.

   b. How did the practices violate the revenue recognition principle?

   c. What were the effects on Minuteman's quarterly financial statements?

[17] http://www.sec.gov/litigation/admin/34-47894.htm ¶ 12.

Suggested responses:[18]

a. *Minuteman kept the books open at the end of each fiscal quarter, so that revenues resulting from sales in the new quarter were reported in the prior quarter's financial statements.*

b. *The revenue recognition principle was violated because the revenues were recorded in a period PRIOR to their actually being earned.*

c. *As a result of improperly recording sales transactions, there was a follow-on effect in the income statement (overstated net income) and in the balance sheet (overstated retained earnings and shareholders' equity.*

As reported in the SEC document[19] *overstated net sales and net income were as follows:*

Three Months Ended	*Overstatement of Net Sales*	*Percentage Overstatement of Net Sales*	*Overstatement of Net Income*	*Percentage Overstatement of Net Income*
03/31/2001	$1,356,000	5.9%	$245,000	23.8%
09/30/2000	$1,218,000	5.4%	$268,000	20.6%
06/30/2000	$748,000	3.3%	$137,000	12.3%
03/31/2000	$352,000	1.5%	$84,000	7.9%
09/30/1999	$534,000	2.4%	$136,000	10.4%
06/30/1999	$977,000	4.9%	$171,000	17.7%
03/31/1999	$438,000	2.2%	$93,000	12.0%
09/30/1998	$631,000	2.8%	$151,000	11.6%
06/30/1998	$195,000	1.3%	$43,000	4.6%
03/31/1998	$783,000	5.1%	$174,000	19.3%

3. Briefly discuss with supporting evidence why Minuteman...[20]

[18] Students can have interesting insights and perspectives, so these suggested responses provide the more important responses, but are not intended to be comprehensively conclusive responses.

[19] http://www.sec.gov/litigation/admin/34-47894.htm ¶ 13.

[20] As a more advanced exercise, the students can compare the management discussion and analysis of operations for the first quarter of 1999 with the MD&A based on the first quarter of 1999 restated. From the chart below it is evident that even though there is a decrease in net sales and an increase of $8,000 in operating expenses, the other items under analysis actually were improved in the restatement report over what was originally reported). (The 1999 first quarter reports can be found at http://www.sec.gov/Archives/edgar/data/810876/0000950137-99-001589.txt (original) and http://www.sec.gov/Archives/edgar/data/810876/000110465901503710/j2568_10qa.htm (restated).)

a. ...overstated its quarterly earnings.

b. ...did NOT overstate its annual earnings.

a. The SEC document in ¶12 states that the new CFO, Thomas J Nolan, believed that the books were held open in order to allow salesmen to get their monthly commissions sooner. This also allowed some of the salesmen, who otherwise would not have met their quarterly sales targets, to qualify for quarterly bonuses.

¶14 notes that as a result of keeping the books open the company was able to make misleading comparisons between quarters, particularly making "bad" news appear less so. For example, in the first fiscal quarter of 2001 the company, using overstated earnings numbers from Q1 2000 and Q1 2001 reported that earnings had decreased from 30¢ per share in Q1 2000 to 29¢ per share in Q1 2001. Since both numbers are overstated, the company report is more glowing than reality warrants, even though showing a decline of 1¢ per share. In the restated Q1 2001 financial report, Minuteman reports that its earnings actually decreased by 5¢ per share, from 27¢ in Q1 2000 to 22¢ in Q1 2001.

b. Why the annual earnings were not overstated can be left to conjecture, because the SEC document does not give a reason. One reason could be that the company did not want to falsify annual earnings which are audited. And there is no indication that the company's revenue recognition problems were the result of an attempt to meet annual earnings targets expected by investors.

Jerome Rau, the CEO who implemented in 1989 the practice of holding open the books, died in 2000 before the SEC investigation began. So he could not be interviewed to determine exactly why the earnings for the first 3 quarters were overstated, and the annual earnings were not. J Rau was succeeded as CEO by his son Gregory Rau. G Rau and the CFO, Thomas Nolan, when they became aware of the practice, allowed it to continue with the assistance of the senior accountant of the company.

Financial Item	Q1 1999 origin	Q1 1999 restate	Difference
Net Sales	$19,199,000	$19,053,000	($146,000)
Change in Sales from same quarter previous year	26.60%	30.90%	4.30%
Gross Profit	$741,000	$881,000	$140,000
Change in GP from same quarter previous year	15%	19%	4.00%
Increase in Operating Expenses from same quarter previous year	$660,000	$668,000	$8,000
Change in Operating Profits from same quarter previous year	5.60%	18.20%	12.60%
Change in Net Income ($) from same quarter previous year	($129,000)	($48,000)	$81,000
Change in Net Income per share from same quarter previous year	($0.03)	($0.01)	$0.02

Since the annual earnings were not overstated, the 4th quarter earnings had to be understated. The SEC document does state (¶14) that the company made misleading statements about the causes of reduced earnings in the 4th quarter, but does not detail any of the reasons. The MD&A in the 10-K (company annual report) for 2001[21] states that 4th quarter sales are "traditionally the company's slowest because of reduced shipments through the holiday period" and particular to 2001 the "$76,000 or 6.8 percent decline was more than accounted for by a one-time service award of $375,000 paid to the estate of Jerome E. Rau, the company's late chairman and CEO. The award recognized Jerry's leadership over the past two decades until his untimely death in September of 2000."

Ethics and Values Questions and Suggested Responses

1. List and briefly discuss two or three Christian/Biblical principles that would provide guidance for this situation.

   Taking the perspective of the 10 commandments – Thou shalt not bear false witness would be a common response. Not only were revenues reported inappropriately, but as a result assets (accounts receivable) and equities (retained earnings) were both overstated. Further, the company, in its discussion of earnings, made false statements based on the mis-stated revenues and earnings.

   Another principle comes from 1 Samuel 15:22 – to obey is better than to sacrifice. While the company may have incurred cost to itself, by granting unearned commissions to benefit the company's salesmen, the violation of the accounting principle for a "good cause" was not justified.

   The 8th command prohibits stealing. Paying bonuses that were not justified or warranted results in theft, not by the company, but rather the company permitted theft of itself by its employees.

2. Imagine that you are a dedicated Christian and the CEO of Minuteman. Describe how your actions were inconsistent with the Christian principles you espouse.

   This case poses an interesting issue. The improper accounting was conducted for an apparently good motive – to help salesmen get commissions they had not earned or to receive commissions sooner rather than later. Teleological ethics would suggest that there was nothing improper about what Minuteman did.

   From a Christian perspective – the ends do not justify the means. Christians should live up to a higher standard that requires transparency in all dealings. If the intention was to pay higher bonuses, this could have been done legitimately. Minuteman's CEO could have initiated changes to the company's bonus policy that were more favorable to the salesmen.

   It is important to note that there were costs to the company. It was paying out cash for bonuses that were not earned by the salesmen and it is possible that there were tax consequences to the company on the reported income that was not earned.

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[21] http://www.sec.gov/Archives/edgar/data/810876/000110465901500032/j0088_ex-13.txt

3. What, if anything, is unethical about misstating the quarterly reports, if the annual report was accurate?

   In Minuteman's favor their annual report, which is subject to audit, was accurate. However, one right report does not make up for three wrong reports over the course of a year. If we are to do right, we are to do so in all things, in not just the bigger or more important matter, but in all matters.

   The quarterly reports were intentionally incorrect, the statements made in relation to the quarterly revenues and earnings were misleading because they were based on incorrect data.

   There is also the possibility that if the company had gotten into financial difficulties during the course of the events it was sanctioned for, it would have already set a precedent for improper accounting in the quarterly reports and could then more easily succumb to overstating the annual earnings in order to project the appearance that business is continuing to go well.

4. Summarize what you believe Jesus would do in such a situation. Substantiate your case with at least two New Testament references, which may be augmented by references from EGW and other religious writers.

   Student answers will vary. Some possible responses could be that Jesus would in all circumstances uphold the highest ethical standards. When He tells the Pharisees to render to Caesar what is Caesar's and to God what is God's (Matthew 22:21), it implies that despite the discomfort, we are to carry out our fiscal duties to the governing body, whether it be the state, to the governing bodies for financial reporting or to the SEC. For Minuteman, this would mean fidelity in accounting for and reporting of sales revenues.

   In Mark 7:21, 22[22] *Jesus condemns, among other things, theft and deceit.*

   In Matthew 25:14-28 (the parable of the talents) – the master entrusted 5, 2 and 1 talent to each of his servants. For those servants who had managed their talents well, the master commended and rewarded their faithfulness.

   Romans 8:1, 2 states "Let every soul be subject to the governing authorities. For there is no authority except from God, and the authorities that exist are appointed by God. Therefore whoever resists the authority resists the ordinance of God, and those who resist will bring judgment on themselves." Taking a broad view of "governing authority" this can include those governing bodies that establish the accounting standards and those responsible for enforcement of those standards.

   Ellen White writes that "those who labor in business lines should exercise every precaution against error through wrong principles or methods. Their record may be like that of Daniel...in all his business transactions, when subjected to the closest scrutiny, there was not found one item that was faulty.[23]

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[22] *For from within, out of the heart of men, proceed evil thoughts, adulteries, fornications, murders, thefts, covetousness, wickedness, deceit, lewdness, an evil eye, blasphemy, pride, foolishness.*

[23] *Special Testimonies to Ministers & Workers*, No. 9, page 66 and also found in *Reflecting Christ*, page 271.

Case #2 – ACL Technologies, Inc

ACL Technologies Inc and its ultimate parent, United Industrial Corporation, is a conglomerate of defense contractors. This is a case of the company paying bribes in order to win additional contracts related to an initial contract that ACL had with the Egyptian Air Force. The company had engaged the services of a retired Egyptian AF General to assist in the process of moving forward the initial project and to aid in securing add-on (further) contracts on the preferred "sole-source" non-competitive bid process.

The EAF consultant pressed the president of ACL to make special payments in order to "motivate" the Egyptian officials to award the contracts to ACL as sole-source. However, the evidence suggests that ACL's president was not eager to make such payments and delayed in doing so.

The documents produced by the SEC provide sufficient detail for the student to understand the defense contracting system, the particulars of the contracts that ACL had to provide goods/services to the Egyptian Air Force and the acts which got ACL and its president into trouble, not just for bribery, but also for falsifying the accounting records in order to account for the cash while keeping its true purpose off the books.

Case Information Sources

Contract Award Announcement - Appendix #3

SEC Complaint against ACL President, Thomas Wurzel -
http://www.sec.gov/litigation/complaints/2009/comp21063.pdf

SEC Settlement (cease & desist order) with UIC (parent company) -
http://www.sec.gov/litigation/admin/2009/34-60005.pdf

Accounting Violation Questions and Suggested Solutions

1. According to the SEC documents, between late 2001 and in 2002 ACL made special payments to its consultant, a retired Egyptian Air Force General. The SEC alleged that the illicit payments of $100,000 and $50,000 were used to motivate Egyptian military officials to award contracts to ACL.

    a. Why did Wurzel authorize the "motivation" payments?

    It appears the reason was to increase the likelihood that ACL would be awarded the contracts from the Egyptian Air Force on a sole-source basis. He evidently was reluctant to do so and for a while ignored the requests for "motivation" money. In April Wurzel paid some "advance" monies saying it would (and it did) deduct the amounts from the pending legitimate labor services invoices sent by the EAF agent. It was shortly after this that a follow-on contract was awarded to ACL.

    There appears to be some linkage between the payments and the awarding of the contracts. In December 2002 ACL made another payment to "keep the momentum going," which it seemed to do since ACL was awarded an additional 5 contracts *between the fall of 2002 and 2004. There is no evidence that any "additional" payments were made after the December 2002.*

The hesitancy of Wurzel to make the payments may indicate that he was not comfortable with the EAF agent's requests. However, as the date to award the contracts got closer he may have felt some pressure to fund the agent's requests in order to maximize the likelihood that the contracts were awarded to ACL and awarded as sole-source contracts.

b. Prepare a timeline of the requests the EAF Agent made for "motivation" payments (complete with amounts), include in your timeline the approximate dates that ACL made the payments and the amounts paid. Be sure that you separate the "motivation" payments from the payments for labor and other services. What, if any, relationships appear to show any relationship of the motivation payments to benefits for ACL?

See Appendix 4 for a detailed time-line. It is apparent, from the time line that the first "motivation" payment occurred just before ACL was awarded the contract in April 2002, providing some evidence that those payments did indeed motivate the EAF to award ACL's the contract.

c. Briefly describe how ACL accounted for the June 10, 2002 payment of $100,000 and its subsequent repayment. Describe what, if anything was improper and/or misleading about the accounting treatment.

Classifying the $100,000 as an expense for the "rental of equipment and contracting of material and services" was an effort to cover up the true use of the funds and to avoid raising any questions by headquarters or auditors who may have reviewed the transaction.

This is what causes a problem for ACL form an accounting point of view. The accounts don't care what the money was spent for but it is an accounting violation to improperly report a transaction. It is against the law (The Foreign Corrupt Practices Act) to pay bribes.

d. Describe the services that were provided for the $50,000 that was paid around December 2002 and explain why they were referred to as "marketing services."

No services were provided. They were apparently labeled as "marketing services" to allow ACL to record the payment to appear as if it were a "legitimate" expense, though it was not legally an expense.

Ethics and Values Questions and Suggested Responses

1. List and briefly discuss two or three Christian/Biblical principles that would provide guidance on handling requests for bribes or "motivation" payments.

The Bible speaks clearly against the paying and taking of bribes, for example, Exodus 23:8, Deuteronomy 16:19, and Ecclesiastes 7:7. Paying bribes blinds the eyes, perverts justice and corrupts the heart.

Isaiah 35:15, 16 states "He who walks righteously, and speaks what is right, who rejects gain from extortion and keeps his hand from accepting bribes,... this is the man who will dwell on the heights, whose refuge will be the mountain fortress. His bread will be supplied, and water will not fail him."

2. Even though they are against U.S. law, in some parts of the world under-the-table payments are considered to be customary. Should a Christian conform or not conform to local customs or practices? Why or why not?

   Local customs and practices should be followed when they are not in direct conflict with God's laws. As Christians our first allegiance is to God and we should conduct ourselves in business as if we were doing business with Him.

3. Summarize what you believe Jesus would do in such a circumstance. Substantiate your case with at least two New Testament references, which may be augmented by references from EGW and other religious writers.

   Student answers will vary, but should emphasize that Jesus would NOT pay a bribe. The first priority would be to submit a proposal or bid that was the best possible and then to work with the Egyptian officials to show the merits of their proposal. The Agent may have been able to provide some assistance in this process, but at the first request for "motivation" monies Jesus would have made it clear that it no money for bribes or motivation would be forth-coming.

   ***From The Review & Herald, Oct 5, 1905 "Lessons from the life of Solomon, #4" -** [The Christian's] course of action is guided by underlying principles. He does not scheme, therefore, he has nothing to conceal, nothing to gloss over. He may be criticized, he may be tested, but his unbending integrity will shine forth like pure gold. He is a blessing to all connected with him, for his word is trustworthy. ... In all the details of life the strictest principles of honesty are to be maintained. These are not the principles which govern our world, for Satan--deceiver, liar, and oppressor--is the master, and his subjects follow him and carry out his purposes. But Christians serve under a different Master, and their actions must be wrought in God, irrespective of all selfish gain ... In the Christian world today fraud is practiced to a fearful extent. God's commandment-keeping people should show that they are above all these things. The dishonest practices which mar the dealing of man with his fellow man should never be practiced by one who professes to be a believer in present truth.*

Case #3 – Corrpro Companies, Inc – Australia Subsidiary

According to its website, Corrpro Companies International, "for over 25 years ... has been a leading provider of cathodic protection systems and engineering services. Corrpro offers corrosion solutions for every industrial market... Corrpro strives to provide high-quality cathodic protection materials and cost-effective services; including engineering, pipeline integrity, construction, and coating inspection. Dedicated to ensuring preservation of energy resources, protection of the environment, and the integrity of the world's infrastructure, Corrpro has more than 30 operating facilities and warehouses worldwide.

In 2000 Corrpro's U.S. headquarters had set earnings and other financial targets for Australian subsidiary. The subsidiary's managing director and financial accountant falsified the books so that it would appear that the targets were met.

To cover the fraud from the corporate controller and the auditors, they fabricated invoices and credit memos, prepared false entries to the accounts and sent fictitious reporting packages to headquarters. And as result of the fraud in the subsidiary, when Corrpro headquarters prepared the consolidated the financial statements for the overall company, they were significantly misstated. The net income for fiscal year 2001 was overstated by $3.6 million or 76.6% and the company's net worth was overstated by 9.2%.

The SEC coordinated with the Australian authorities, who also brought a criminal case against the managing director and financial accountant. In the Australian criminal case, the managing director pled guilty to eight charges brought against him and was sentenced to 34 months, but the sentence was reduced four months served. The financial accountant pled guilty to five charges brought against him and was sentenced to 10 years, though he only served two months.

Note – Corrpro is one of a small group of companies that have been subject to SEC enforcement action more than once. The first enforcement action against Corrpro for activities in 1994-1995 that overstated revenues and assets and understated expenses and liabilities. Now Corrpro includes on its website the company's code of ethics, *The Code of Conduct*, and a Code of Ethics for Senior Financial Officers.[24]

Case Information Sources

SEC Financial Fraud Action - http://www.sec.gov/litigation/litreleases/lr18382.htm

SEC Complaint - http://www.sec.gov/litigation/complaints/comp18382.htm

Corrpro Companies, Inc. Consent - http://www.sec.gov/litigation/litreleases/lr18547.htm

Sentencing of Managing Director - http://www.asic.gov.au/asic/asic.nsf/byheadline/04-377+Former+Corrpro+managing+director+jailed+for+fraud?openDocument

Sentencing of Financial Accountant - http://www.asic.gov.au/asic/asic.nsf/byheadline/04-155+Accountants+of+American+subsidiary+sentenced?openDocument

Accounting Violation Questions and Suggested Solutions[25]

1. Briefly describe why the financial records of Corrpro's Australian subsidiary were falsified.

   In order to meet the earnings targets set by the parent company.

2. List at least four (4) irregular activities that Corrpro Australia's staff engaged in.

   1) Preparing false journal entries in the general ledger and subsidiary ledgers.

[24] http://www.corrpro.com/code_of_conduct.htm and http://www.corrpro.com/code_of_ethics.htm

[25] There are a number of questions in this case that address the accounting violations. This case is a bit more complex than the first two cases and it is important that the students understand and are able to describe what happened in terms of the violation of accounting principles and the consequences, which are widespread and affect the financial accountant and managing director, all the employees (since the company subsequently was liquidated), the parent company, and the shareholders.

2) Preparing false invoices and preparing fictitious invoices.

3) Fabricating backup documents to support the false journal entries.

4) Preparing false credit notes (i.e., credit memos) to reduce the amount of reported accounts payable.

5) Preparing false reporting packages.

3. What was the magnitude of the subsidiary's fraud and effects on the consolidated financial statements of Corrpro Companies International? Be specific as to the amounts and the financial reporting periods.

   Net income for FY 2001 was over stated by $3.6 million or by 76.6% ($3.6M ÷ $4.7M).

   Net income for Q1, FY 2002 was overstated by $451,000, turning a $226,000 profit into a profit of $225,000.

   Net income for Q2, FY 2002 was overstated by $763,000, going from $134,000 of actual profit to $897,000 reported profit for the quarter.

   Net Income for Q3, FY 2002 was overstated by $474,000, going from an actual profit of $71,000 to $545,000 of reported profit for the quarter.

4. What happened to the managing director and the financial accountant of the Australian subsidiary after the fraud was prosecuted?

   The Australian authorities sentenced both to prison; though their sentences were either reduced to time served or were suspended.

5. What ultimately happened to the Australian subsidiary? Describe the effect on the Corrpro Company's investment in the Australian subsidiary.

   The subsidiary eventually was liquidated and the investment on the books of the parent company was written off to the tune of $2.48 million.

6. What was the impact on Corrpro's shareholders as a result of the accounting irregularities?

   The stock price dropped 52% from $2.30 per share to $1.10 per share. Market capitalization for the company fell by over $10M.

7. The SEC filed an injunction against the parent company, Corrpro Companies International. Why do you think the SEC would file suit against the parent company if the SEC knew that the parent company did not know of the fraud in the Australian subsidiary and when it was discovered the parent took immediate remedial action to correct the problem?

   Student answers will vary. The core problem was that Corrpro's internal controls failed and this is why the SEC cited the parent company. The parent was neglectful in its oversight of the accounting at the Australian subsidiary. When the headquarters no longer required its subsidiaries to submit their trial balance with the monthly reporting packages, it actually loosened the controls and made it easier for each subsidiary to submit false reports. Further, when the corporate controller requested financial records for review, the Australian subsidiary "could or would not" produce the records. That the subsidiary was able to take two weeks before submitting the records for review, indicates that more controls than just the internal controls were deficient.

Ethics and Values Questions and Suggested Responses

1. List and briefly discuss two or three business/accounting ethics principles that would provide guidance for this situation. (The AICPA website[26] or an internet search can help you locate important ethical principles relating to accounting and business).

   Student answers will vary and could include Integrity, Trustworthiness, Honesty, Fidelity, Industriousness and Diligence.

2. List and briefly discuss two or three Christian/Biblical values that would provide guidance to someone in the position of either managing director or financial accountant who is pressed to meet earnings targets from company headquarters.

   First it is the responsibility of the employee to carefully plan and take reasoned risks to accomplish the objectives or targets. Mwanahiba, referring to Proverbs 6:6-8, states that one must be "industrious, make careful and well thought out budgets and wise investments of any organization's resources that make provisions for good future returns to the investor."[27]

   At times, the best laid plans and hard work do not result in the desired outcomes. The principles of honesty and faithfulness should guide decision-making and action-taking. The principle of honesty comes not only from the 9th commandment (Exodus 20:16), but also from the writings of the Apostle Paul in Galatians 6:7 – "Do not be deceived, God is not mocked; for whatever a man sows, that he will also reap." If honesty doesn't come spontaneously as a result of doing the right thing because it is the right thing to do, then honesty may result from a motivation of avoiding the consequences of dishonest behaviors (Romans 13:5). The principle of faithfulness is described in the parable of the talents - Matthew 25:14-30, where those servants who had been faithful were rewarded for their faithfulness, loyalty and trustworthiness.

3. Summarize what you believe Jesus would do in such a circumstance. Substantiate your case with at least two New Testament references, which may be augmented by references from Ellen White and other religious writers.

   Student answers will vary, but should do so along the theme that Jesus would be honest in accounting and reporting financial results to headquarters. The apostle Paul in Ephesians 6:7 writes "Serve wholeheartedly, as if you were serving the Lord, not men." The admonitions of 1 Thessalonians 5:15 "always pursue what is good both for yourselves and for all" would apply in this case, where the actions were only temporarily beneficial for the Australian subsidiary and in the long run were not good for anyone. In Titus 3:1 is written "be subject to rulers and authorities, to obey, to be ready for every good work."

   Ellen White writes "How many a man might have escaped financial failure and ruin by heading the warnings, so often repeated and emphasized in the Scriptures:... 'Wealth

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[26] http://www.aicpa.org/about/code/et_54.html

[27] Davison B Mwanahiba, *The Accounting Lecturer's Role in Integrating Biblical Values with Learning.* Christ in the Classroom, Vol. 28.

gotten in haste shall be diminished: but he that gathereth by labor shall have increase.' Proverbs 13:11, R.V., margin."[28]

Conclusion

Teaching ethics and values in accounting courses has been acknowledged as an important goal for the accounting professor. In the current business environment, where it seems that all too regularly there are revelations of accounting fraud in public and private companies, it is imperative that in Seventh-day Adventist institutions of higher learning we deliberately encourage our accounting students to think about ethics and values from a Biblical perspective. The objective of this paper is to integrate the teaching of accounting principles with ethics and Bible-based values using case studies of real-world instances of accounting fraud. Using case studies, the student can more fully understand accounting principles and develop the basis for a Biblical, ethical and values-based decision making process in business and, particularly, in accounting.

The cases are taken from U.S. Securities & Exchange Commission enforcement actions. Questions and proposed responses are provided to help the student to understand both the accounting standard that was violated and the ethical principles and Biblical values that should have guided decision-making. Finally the student is asked to answer the question "What would Jesus have done?" and to support their views with New Testament references. I have provided suggested responses, with Biblical references for the ethics/values questions, as a guide for teaching and discussing the case.

Ethics should be a critical element of accounting education and in the Seventh-day Adventist College, the ethics taught should also be Biblical-based. Using cases of accounting fraud provides a launching pad for integrating ethics and values in the accounting classroom. If using these cases helps some students begin to purposefully think of their values from a Biblical perspective and in future to make decisions consistent with what Jesus would have done, my goal will be accomplished.

Appendix #1 – Minuteman International Assignment

Minuteman International Inc, according to its website,[29] produces "commercial, industrial, and chemical cleaning products," including cleaning supplies and commercial and industrial cleaning equipment. According to Hoovers, "janitors with wood-handle mops and tin buckets dream about Minuteman International"[30] and its quality floor and carpet care products, cleaning chemicals, carpet sweepers, scrubbers, and the like.

The company was founded in 1951 as the American Cleaning Equipment Corporation and is currently headquartered in Addison, Illinois USA. At the time of the events of this case, between 1989 and 2001, the company was a publicly traded company. But in 2004 Minuteman was purchased by Hako-Werke International, a German company, and was taken private.

Read the SEC Administrative Proceeding[31] against Minuteman, http://www.sec.gov/litigation/admin/34-47894.htm and answer the questions below.

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[28] White, Ellen G. 1903. *Education.* Pacific Press. Page 136.
[29] http://www.minutemanintl.com/
[30] http://www.hoovers.com/minuteman-international/--ID__13630--/free-co-profile.xhtml
[31] The SEC enforcement action can also be found at http://groups.google.com/group/sec-enforcement-actions, "Minuteman AAER 1786".

Assigned questions

1. According to the SEC, Minuteman improperly reported its quarterly revenues during 1989 to 2001.
   a. Briefly describe the conditions that must be met in order for a company to record revenue on its books (i.e., the revenue recognition principle).
   b. Describe Minuteman's revenue recognition practices. How did the practices violate the revenue recognition principle? What were the effects on Minuteman's quarterly financial statements?
   c. Briefly discuss with supporting evidence why Minuteman...
      i) Overstated its quarterly earnings.
      ii) Did NOT overstate its annual earnings.
2. What, if anything, is unethical about misstating the quarterly reports, if the annual report was accurate?
3. List and briefly discuss 3 or 4 business/accounting ethics principles that would provide guidance for this situation. (The AICPA website[32] or an internet search can help you locate important ethical principles relating to accounting and business).
4. List and briefly discuss two or three Christian/Biblical principles that would provide guidance on handling requests for bribes or "motivation" payments. Support your case with Biblical references, which may be augmented by references from EGW and other religious writers.
5. Summarize what you believe Jesus would have done.
6. Imagine that you are a dedicated Christian and the CEO of Minuteman. Describe how your actions were inconsistent with the Christian principles you espouse.

Appendix #2 – ACL Technologies, Inc

ACL Technology for Business Assurance

ACL Technologies Inc and its ultimate parent, United Industrial Corporation, are a conglomerate of defense contractors. ACL, according to SEC filings, "developed, operated and maintained ... test equipment" related to military aircraft. The company, though the U.S. Department of Defense, was in the process of bidding on work for the Egyptian Air Force and had engaged the services of a retired Egyptian AF General to assist in the process of moving forward the initial project and to aid in securing add-on (further) contracts on the preferred "sole-source" non-competitive bid process.

Read the SEC Cease & Desist Proceedings against United Industrial Corporation, http://www.sec.gov/litigation/admin/2009/34-60005.pdf, the SEC Complaint against ACL President, Thomas Wurzel, http://www.sec.gov/litigation/complaints/2009/comp21063.pdf and answer the questions below.

Assigned questions

1. According to the SEC documents, between late 2001 and in 2002 ACL made special payments to its consultant, a retired Egyptian Air Force General. The SEC alleged that the illicit payments of $100,000 and $50,000 were used to motivate Egyptian military officials to award contracts to ACL.
   a. Why did Wurzel authorize the "motivation" payments?
   b. Prepare a timeline of the requests the EAF Agent made for "motivation" payments (complete with amounts), include in your timeline the approximate dates that ACL made the payments and the amounts paid. Be sure that you separate the "motivation" payments from the payments for labor and other services. What, if any, relationships appear to show any relationship of the motivation payments to benefits for ACL?

[32] http://www.aicpa.org/about/code/et_54.html

c. Briefly describe how ACL accounted for the June 10, 2002 payment of $100,000 and its subsequent repayment. Describe what, if anything was improper and/or misleading about the accounting treatment.

d. What marketing services were provided for the $50,000 paid around December 2002?

2. List and briefly discuss 3 or 4 business/accounting ethics principles that would provide guidance for this situation. (The AICPA website[33] or an internet search can help you locate important ethical principles relating to accounting and business).

3. List and briefly discuss two or three Christian/Biblical principles that would provide guidance on handling requests for bribes or "motivation" payments. Support your case with Biblical references, which may be augmented by references from EGW and other religious writers.

4. Summarize what you believe Jesus would have done.

5. Even though they are against U.S. law, in some parts of the world under-the-table payments are considered to be customary. Should a Christian conform or not conform to local customs or practices like these? Why or why not?

Appendix #3 – ACL Contract Award Letter

United Industrial Subsidiary Awarded Letter Contract and Initial $14 Million Funding from Hill Air Force Base[34]

October 25, 1999

United Industrial Corporation (NYSE: UIC - news) today announced that its ACL Technologies (ACL) subsidiary has received a letter contract to initiate all efforts necessary to perform as the Integration Contractor for the construction of a F-16 maintenance depot in Egypt.

Awarded by Hill Air Force Base in Ogden, Utah, the contract is part of the Foreign Military Sales program between the United States and the Government of Egypt. The contract will be completed over a two-year period and will provide the Egyptian Air Force with the capability to repair and overhaul over 350 components on the F-16 Fighter Aircraft. ACL will receive initial funding of $14 million, pending final agreement on the entire scope of work. The full contract is valued at up to $28 million, with additional options to be considered.

Under the contract, ACL will purchase, manufacture and integrate equipment and provide other services necessary to establish a component overhaul capability for the Egyptian Air Force. The scope of the contract includes, fuel, hydraulics, pneumatics, oxygen, landing gear, electrical, instrument and machine shops, all of which will be located near Cairo, Egypt.

Richard R. Erkeneff, United Industrial's President and Chief Executive Officer, commented, "This contract award represents an important milestone in our ongoing strategy to build United Industrial's ACL Technologies business. ACL's performance in providing equipment and services to the F-16 depot programs is second to none, and we are particularly proud that both the United States Air Force and the Egyptian Air Force have designated ACL as their Integration Contractor. We expect that as other nations initiate their own efforts to obtain depot capability, this will provide additional opportunities for ACL."

ACL Technologies, located in Brea, California, is a leader in providing test equipment and services to the aerospace industry.

United Industrial Corporation is a high technology company focused on the design and production of defense, training, transportation, and energy systems. Its products include unmanned air vehicles, training and simulation systems, automated aircraft test and maintenance equipment, and ordnance systems. It also manufactures ground transportation components, combustion equipment for biomass and refuse fuels, and specialized firefighter training installations...

Provided by: AAI Corporation

[33] http://www.aicpa.org/about/code/et_54.html

[34] http://www.govcon.com/article.mvc/United-Industrial-Subsidiary-Awarded-Letter-C-0001?VNETCOOKIE=NO