GREEDY GRANNIES: A CASE STUDY

Dwayne Powell, MBA, CPA
Instructor of Accounting
Arkansas State University
Corresponding Author
P.O. Box 550
State University, Arkansas 72467
870-972-3038
dpowell@astate.edu

Rodney F. Carmack, MBA, CPA, CGMA
Instructor of Accounting
Arkansas State University
P.O. Box 550
State University, Arkansas 72467
870-972-3038
rcarmack@astate.edu

Tina Quinn, PhD, CPA
Emeritus Professor of Accountancy
Arkansas State University
P.O. Box 550
State University, Arkansas 72467
870-972-3038
tquinn@astate.edu

ABSTRACT

May 15, 2015 started out as an ordinary day at the First State Bank of Smallville, but it soon became an extraordinary day when a surprise cash count began. The cash count revealed a massive cash shortage that shocked the bank officials and all the employees except three employees. A subsequent investigation discovered a theft of almost $4.5 million that had taken place over approximately a ten-year period.

The culprits were three employees who had a total of over 100 years of employment at the bank. The news shocked not only the bank employees but the residents of this close-knit community. All three of the perpetrators were lifelong residents of the area. Linda Black, 55 years old, was a teller. Patty White, 59 years old, was the head teller while Sandy Brown, also 55, was head cashier.

BACKGROUND

The First State Bank (FSB) of Smallville offers personal and commercial banking services through its home bank and multiple branches within approximately a 50-mile radius of Smallville. The bank was founded in 1919 to serve the local agricultural community. The bank has been majority owned by the Jones family since 1965 when Bob Jones, Sr. became the majority shareholder. His son, Bob Jones, Jr., was the majority shareholder from 1967 until his death in 1994. Bob, Jr.'s son, John Jones, then became the bank president and the Jones family remain the majority shareholders. Employees and outsiders own a minority share of the stock. The bank has approximately 60 employees, many of whom have been with the bank for numerous years.

Smallville is a small town located in a rural area where agriculture is the major industry. Most residents of Smallville have been life-long residents and know their neighbors well. With only two school systems in town, most residents either attended school in Smallville or have children currently in the school system.

Such was the case with the Jones family and the perpetrators. In this close-knit community, the Jones siblings had known the culprits since they were children. Linda Black, teller, had worked at the bank for 35 years. Patty White, head teller, had been employed at the bank for 36 years and Sandy Brown, head cashier, had been employed at the bank for 32 years.

As teller, Linda Black's responsibilities including greeting customers, processing deposits and withdrawals as well as assisting customers with other banking transactions. Her primary duty was to balance the cash drawer at the end of the day.

As head teller, Patty White's duties included supervising and coordinating the activities of the tellers engaged in receiving and paying out cash and keeping records of such transactions. Other duties include examining the tellers' reports of daily transactions, consolidating and balancing daily transactions, ensuring the supply of money for the bank's needs based on legal requirements and business demand. Duties also included allowing customers access to safe deposit boxes, controlling access to the vault, and counting and recording currency in the vault.

As head cashier, Sandy Brown was responsible for managing her department as well as maintaining the Bank's fiscal record keeping system by using generally accepted accounting principles. Sandy was also responsible for the record-keeping system to comply with tax law and banking regulations to reflect the financial position of the bank properly.

The perpetrator's collective duties put them in charge of reconciling cash in the tellers' drawers and the bank vault and the transfers of funds between branches. They took cash from the vault while coordinating the records to hide the theft. In her capacity as head cashier, Sandy would receive advance notice of internal audits. The three would then move cash to the bank's main vault from branch banks and/or corresponding banks. The employees moved the money back after the audit was complete. The employees used an account titled "cash in transit" as well as actual cash transfers to hide the cash deficits in the bank vault.

An IT employee became suspicious when Sandy refused to let anyone else access the perpetrator's records. The IT department then began monitoring the perpetrator's emails. When IT became convinced that a crime was taking place, the bank's President (Mr. Jones) was alerted. He immediately contacted an outside audit firm (one never used by the bank) and requested a surprise cash count that revealed a shortage.

When a forensic audit confirmed the shortage, Jones confronted Patty who confessed and implicated the other two employees that were involved in the fraud. Although Linda and Sandy denied the allegation, they eventually confessed. Patty was so distraught that she attempted suicide. Sandy filed bankruptcy. All three employees immediately hired lawyers. The lawyers, to minimize penalties, alerted the US Attorney before the US Attorney charged the employees with a crime.

In May 2016, the perpetrators pled guilty to conspiracy to commit bank fraud and the judge ordered that they be released on bail. Possible penalties included a maximum of 30 years imprisonment, $1 million fine; five years supervised release and a $100 special assessment. However, the perpetrators and their attorneys negotiated a plea agreement that would require the perpetrators to each repay one-third of the money ($1,5M) and serve a sentence of between 41 and 57 months in prison.

In September 2016, the Jones siblings (John and his sisters Ann and Jane), as well as several shareholders and bank employees, attended the sentencing hearing. They expressed a tremendous amount of frustration and anger over the short sentences. Several of the victims delivered victim impact statements in hopes of swaying the judge to levy the longest possible sentence. Although the bank recovered $2.5 million through private insurance, the shareholders absorbed the remaining loss. The shareholders also lost potential dividends and employees lost potential bonuses. Ann Jones strongly criticized the employees for tarnishing the reputation of the bank and for causing the shareholders and employees financial loss. She demanded the maximum penalty for all the perpetrators.

Despite the Jones' efforts, the judge handed down a sentence of 51 months and required the perpetrators to each repay their share of the stolen money. The judge justified the decision by pointing out that the plea deal saved the government the time and expense of a trial. The court also considered other factors such as the amount of money taken, the lack of a criminal record and the sophistication of the crime.

Requirements:

Identify and discuss the internal control deficiencies that allowed the trio to perpetrate their fraud.

Identify preventive, detective and corrective controls that should have been in place at FSB.

Discuss the Fraud Triangle. How do the concepts of the Fraud Triangle apply to this case?

Define collusion and the challenges it presents to internal controls.

TEACHING NOTES

SUMMARY

The First State Bank of Smallville offers personal and commercial banking services through its home bank and multiple branches within approximately a 50-mile radius of Smallville. The bank was founded in 1919 to serve the local agricultural community. The bank has been majority owned by the Jones family since 1965 when Bob Jones, Sr. became the majority shareholder. His son, Bob Jones, Jr., was the majority shareholder from 1967 until his death in 1994. Bob, Jr.'s son, John Jones, then became the bank president and the Jones family remain the majority shareholders. Employees and outside shareholders own a minority share of the bank. The bank has approximately 60 employees, many of whom have been with the bank for numerous years.

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The perpetrators were three employees who had a total of over 100 years of experience with the bank. The news shocked not only the bank employees but the residents of this close-knit community. All three perpetrators were lifelong residents of the area. Linda Black, 55 years old, was a teller. Patty White, 59 years old, was the head teller while Sandy Brown, also 55, was head cashier.

TEACHING OBJECTIVES AND TARGET AUDIENCE:

Teaching objectives:

The student should be able to:

- Identify weaknesses in internal controls.
- Understand how such weaknesses could lead to theft.
- Discuss measures to prevent and detect cash larceny.
- Understand and identify methods used by fraudsters to conceal cash larceny.
- Recognize how collusion could make some controls ineffective.
- Apply the fraud triangle.

Instructors could use this case in an Auditing, AIS, Fraud Examination or any other class that addresses internal control systems.

Questions for each class are:

- Identify and discuss the internal control deficiencies that allowed the employees to perpetrate their fraud.
- Discuss steps that may be taken to prevent collusion.
- Identify preventive, detective and corrective controls that should have been in place at First State Bank.
- Discuss the fraud triangle.
- How do the concepts of the fraud triangle apply to this case?
- What is collusion and what challenges does internal control face when collusion is present?
- Who is responsible for designing, maintaining and monitoring an internal control system?

ANALYSIS:

Identify and discuss the internal control deficiencies that allowed the trio to perpetrate their fraud.

The internal control deficiencies that allowed the trio to perpetrate their fraud included:

- Lack of an appropriate system of internal control.
- The frequency of audits was inadequate.
- Lack of appropriate supervision and review.
- Lack of multiple levels necessary to authorize transactions.
- Giving any employee notice of cash counts before the counts occurred.

Identify preventive, detective and corrective controls that should have been in place at FSB.

- Computer user access should be limited to specific roles and responsibilities.
- Increase multiple layers of authority.
- There should be secondary approval of transactions.
- Video surveillance cameras should be in place and reviewed.
- There should be a rotation of duties when appropriate.
- Cross-train employees.
- Enforce a mandatory vacation policy.
- Reqiure another employee to perform the vacationing employee's duties.
- Expand and enhance the internal audit function.
- The audit committee should be involved in the audit functions (internal and external).
- Perform <u>**surprise**</u> cash counts.

Discuss the fraud triangle.

According to Cressey's fraud triangle, three factors contribute to fraudulent activity. Those three factors are a perceived non-shareable financial need, perceived opportunity and rationalization.

- Pressure is generally present when the perpetrators do not believe they can share a real or perceived problem. In this case, no motive other than greed appeared to be present.
- The employees had the opportunity to perpetrate the fraud as they were given too much authority over too many transactions.
- Rationalization occurs before a fraud takes place. One of the perpetrators rationalized that her low self-esteem caused her to participate in the theft.

Define collusion and discuss steps that may be taken to prevent collusion.

Collusion occurs when two or more individuals work together to commit and cover-up a crime.

The following efforts could have helped prevent the collusion:

- Surprise cash counts.
- Mandatory vacations.
- Rotate duties.
- Perform detailed review of daily financial statements by independent employees.
- Enhanced internal audit function.