Case Study 4: Cash Control and Theft

Instructions:

1. Print and read the following case study.
2. On your own, complete the **Accounting Application** questions.
3. As a class, complete the **Class Interaction and Discussion** questions.
4. Optional: Complete the **Small Group Extension Activity** and **Internet Exploration and Research Activity**.
5. Complete the **Summary Questions**.

Objectives:

After completing the following case study, you will be able to:

- Describe several security procedures used by businesses to discourage employee theft
- Compare the effect of employee theft on net income
- Discuss different examples of employee theft
- Identify four internal cash controls described in the text

Study Tips:

Complete this case study after Chapter 11, Glencoe Accounting, First-Year Course. Approximate time to complete: 45 minutes.

Overview:

The following information was obtained from “The Heavy Burden of Light Fingers,” *BusinessWeek* (December 16, 1996), by Barbara Hetzer.

One day while his bookkeeper was at lunch, Ron Knight, owner of a construction business in Gilbert, Arizona, happened to open the mail. Usually only the bookkeeper reviewed bank statements, but on this afternoon, Knight discovered a cancelled check made out to the bookkeeper for $1,000. After some exploration, Knight learned that during the past six months, the bookkeeper had taken a total of $20,000.

Most experts believe that while all businesses have some problems with employee theft, small businesses are more affected by it. A fraud examiners’ study found that small businesses suffered a median loss of $120,000 per incident, but the loss for companies with 10,000 or more employees was reported to be $126,000. As you can imagine, $120,000 is much more important to smaller businesses than $126,000 is to companies with 10,000 employees. Therefore, the loss to smaller businesses is more devastating.

Small businesses also run a greater risk for employee theft because of the high level of trust that exists between owners and employees. Chris Daniel, who owns a small advertising firm in Charlotte, North Carolina, treated employees like family until his bookkeeper allegedly took $122,000.

Small businesses can defend themselves. By adding a few security procedures, they can discourage employee theft or catch it early. The following are safeguards against theft:

1. Limit the number of persons who handle cash.
2. Separate accounting tasks to decrease the likelihood of theft. The person who handles cash receipts and payments should not keep the accounting records that show amounts received or paid out.
3. Insure or bond employees who handle cash.
4. Use a safe or a cash register.
5. Deposit cash receipts daily.
6. Use checks to make as many cash payments as possible.
7. Prepare a written code of ethics. Owners should spell out which uses of company resources they view as theft.
8. Screen prospective employees very thoroughly. Use court records and credit references. This can reduce fraud losses by as much as 30%.
9. Examine the company’s bank statements.
10. Motivate employees by tying a portion of compensation to a reduction in shrinkage (company losses due to theft, paperwork errors, and so on).

Accounting Applications:

Instructions: Now that you have reviewed the case study above, answer the following questions on your own.

Consider the following scenario. Richard, A-1 Rental's bookkeeper, had complete control of cash. This past year, he misrepresented the expense of building maintenance by $250 per month and, by explaining to the owner that the maintenance company preferred to be paid in cash, cashed the maintenance fee check, keeping the extra $250. Over the course of the year he accumulated $3,000 in cash.

Revenue for this year ended December 31 was $85,674 in fees.

Expenses were recorded as:

Salaries	$45,000
Advertising	12,000
Maintenance	9,000
Rent	14,400
Utilities	1,500

1. Prepare an income statement using the amounts given.

A-1 Rental

Income Statement

For the Year Ended December 31, 20--

2. Prepare another income statement that reflects the true expenses for the year.

A–1 Rental

Income Statement

For the Year Ended December 31, 20--

3. Compare net incomes. What is the difference in net income?

4. Richard also often takes office supplies for his use at home. The cost of a box of pens is $15. Over the course of one month, the company uses 2.5 boxes of pens. Richard takes a box home per month. What does this cost the company in a year?

Class Interaction and Discussion:

Instructions: Read the following question. As a class, discuss your responses.

Discuss examples of employee theft.

Optional Small Group Extension Activity:

Instructions: Break into small groups of three or four students. Discuss your answers to the following.

> Imagine that you are the owners of a small business. After choosing a small business, write the part of your company's code of ethics that describes which uses of company resources you would view as theft.

Optional Internet Exploration and Research Activity:

Instructions: Using the Internet, research the following activity.

Find two articles about employee theft written in the past five years. They can be newspaper or magazine articles. You could use a newspaper or magazine Web site; e.g., *BusinessWeek's* site at www.businessweek.com or E*ntrepeneur's* site at www.entrepeneur.com. Write a brief report giving the title, author, publisher, and date of each article.

Summary Questions:

1. Describe the purpose of cash controls.

2. List four internal cash controls.