CASE 3.1

First Keystone Bank

A Japanese bank introduced the concept of around-the-clock access to cash in the 1960s when it installed the world's first cash-dispensing machine. In 1968, the first networked ATM appeared in Dallas, Texas.[1] Two generations later, there are more than two million "cash-points," "bancomats," and "holes-in-the-wall" worldwide, including one in Antarctica.

Not surprisingly, ATMs have been a magnet for thieves since their inception. In 2009, an international gang of racketeers used a large stash of counterfeit ATM cards to steal $9 million from hundreds of ATMs scattered around the globe in a well-planned and coordinated 30-minute crime spree. Several high-tech thieves have hacked into the computer networks of banks and modified their ATM software. One such miscreant reprogrammed a network of ATMs to change the denomination of bills recognized by the brainless machines–the ATMs treated $20 bills as if they were $5 bills. High-powered video cameras and miniature electronic devices attached to ATMs have been used to steal personal identification numbers (PINs) from a countless number of unsuspecting bank customers.

A variety of low-tech schemes have also been used to rip off banks and their customers via ATMs, including forced withdrawals and post-withdrawal armed robberies. "Ram-raiding" involves using heavy-duty equipment to rip an ATM from its shorings. The ram-raiders then haul the ATM to a remote location and blast it open with explosives. The most common and lowest-tech type of ATM pilfering involves the aptly named tactic of "shoulder-surfing."

Many banks have suffered losses from their ATM operations due to embezzlement schemes perpetrated by employees. One such bank was the Swarthmore, Pennsylvania, branch of First Keystone Bank. Swarthmore, a quiet suburb of Philadelphia, is best known for being home to one of the nation's most prestigious liberal arts colleges. In 2008, *Forbes Magazine* ranked Swarthmore College as the fourth best institution of higher learning in the United States–Princeton, CalTech, and Harvard claimed the top three spots in that poll.

In January 2010, three tellers of First Keystone's Swarthmore branch were arrested and charged with stealing more than $100,000 from its ATM over the previous two years. The alleged ringleader was Jean Moronese, who had worked at the branch since 2002 and served as its head teller since 2006. According to media reports, Moronese told law enforcement authorities that she initially began taking money from the branch's ATM in 2008 to pay her credit card bills, rent, and day care expenses.

No doubt emboldened by the ease with which she could steal the money, Moronese reportedly began taking cash from the ATM "just to spend" because she "got greedy."[2] Prior to taking a vacation in the fall of 2008, a tearful Moronese approached one of her subordinates and fellow tellers, Kelly Barksdale, and confessed that she had been stealing from the ATM. Moronese "begged" Barksdale to help her conceal her thefts "because she didn't want her children to see her go to jail."[3] Barksdale was

1. In the United States, "ATM" generally refers to an "automated teller machine" or "automated transaction machine." In some English-speaking countries, however, "ATM" refers to "all-time-money."
2. C. Scharr, "Bank Employees Charged in Embezzlement Scheme," *The Delaware County Daily Times* (online), 12 January 2010.
3. M. Schaefer, "Ex-tellers at Swarthmore Bank Charged in Theft," www.philly.com, 12 January 2010.

apparently persuaded by Moronese's tearful plea and agreed to help her cover up the embezzlement scheme.

In fact, the cover-up was easily accomplished. According to the local police, Moronese and Barksdale simply changed the ledger control sheets that were supposed to report the amount of cash stored in the ATM and in the locked vault within the ATM. First Keystone's internal control procedures mandated that two employees be involved in resupplying the ATM and its locked vault and in maintaining the ATM ledger control sheets. However, either Moronese or Barksdale completed those tasks by themselves.

In early 2009, a third teller, Tyneesha Richardson, overheard Moronese and Barksdale discussing the embezzlement scheme. Richardson then reportedly asked Moronese for money to pay off her car loan. Moronese agreed to give Richardson the money and told her that she shouldn't worry because "the bank had a lot of money and they would never miss it."[4,5] After telling Barksdale that she had given money to Richardson, Moronese told Barksdale that if she ever needed any money "to let her know."[6] Not long thereafter, Barksdale allegedly asked Moronese for $600 to pay her rent.

An internal audit eventually uncovered the embezzlement scheme at First Keystone's Swarthmore branch. That internal audit revealed that $40,590 was missing from the branch's ATM, while another $60,000 was missing from the locked vault within the ATM's interior.

While being interrogated by law enforcement authorities, Barksdale reportedly confessed that she and her colleagues had also stolen money from the local municipality. City employees periodically dropped off at the First Keystone branch large bags of coins collected from Swarthmore's parking meters. Tellers at the branch were supposed to feed the coins into a coin-counting machine and then deposit the receipts printed by the machine into the city's parking account. According to Barksdale, she and her two fellow conspirators diverted money from Swarthmore's parking funds and split it among themselves. The police estimated that the three tellers stole approximately $24,000 of the parking funds.

In January 2010 when the three tellers were arrested, they did not have to go far since the Swarthmore police station was across the street from the First Keystone branch where they worked. In commenting on the case, the local district attorney observed that Barksdale and Richardson had a choice to make when they learned of Moronese's embezzlement scheme and that each had made the wrong choice. "So, the lesson is you can either be a witness or you can be a defendant. These two chose to be defendants."[7]

The district attorney also commented on the branch's failure to require employees to comply with internal control procedures. "The case is yet another example of the importance of not only implementing internal accounting safeguards, but ensuring that those safeguards are being followed by all employees at all levels of the business."[8,9]

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4. Scharr, "Bank Employees Charged."
5. While at work, the three coworkers reportedly used the code word "Todd" to refer to "their friend" when they needed or wanted to take money from the ATM.
6. Scharr, "Bank Employees Charged."
7. Schaefer, "Ex-tellers at Swarthmore Bank."
8. Press release issued January 11, 2010, by G. Michael Green, District Attorney, Delaware County, Media, Pennsylvania. (http://www.delcoda.com/documents/FirstKeystoneStatement byMikeGreen.pdf)
9. In March 2010, an employee of First Keystone's branch in Berwick, Pennsylvania, pleaded guilty to embezzling $750,000 over the 17 years that she had worked for that branch. According to published reports, the employee routinely "skimmed" money received by the bank and deposited the stolen funds into bank accounts that she controlled.

Questions

1. Prepare a list of internal control procedures that banks and other financial institutions have implemented, or should implement, for their ATM operations.
2. What general conditions or factors influence the audit approach or strategy applied to a bank client's ATM operations by its independent auditors?
3. Identify specific audit procedures that may be applied to ATM operations. Which, if any, of these procedures might have resulted in the discovery of the embezzlement scheme at First Keystone's Swarthmore branch? Explain.

CASE 3.2

Howard Street Jewelers, Inc.

Lore Levi was worried as she scanned the most recent monthly bank statement for the Howard Street Jewelers.[1] For decades, she and her husband, Julius, had owned and operated the small business that they had opened after fleeing Nazi Germany during World War II. Certainly the business had experienced ups and downs before, but now it seemed to be in a downward spiral from which it could not recover. In previous times when sales had slackened, the Levis had survived by cutting costs here and there. But now, despite several measures the Levis had taken to control costs, the business's cash position continued to steadily worsen. If a turnaround did not occur soon, Lore feared that she and her husband might be forced to close their store.

Lore had a theory regarding the financial problems of Howard Street Jewelers. On more than one occasion, she had wondered whether Betty the cashier, a trusted and reliable employee for nearly 20 years, might be stealing from the cash register. To Lore, it was a logical assumption. Besides working as a part-time sales clerk, Betty handled all of the cash that came into the business and maintained the cash receipts and sales records. If anybody had an opportunity to steal from the business, it was Betty.

Reluctantly, Lore approached her husband about her theory. Lore pointed out to Julius that Betty had unrestricted access to the cash receipts of the business. Additionally, over the previous few years, Betty had developed a taste for more expensive clothes and more frequent and costly vacations. Julius quickly dismissed his wife's speculation. To him, it was preposterous to even briefly consider the possibility that Betty could be stealing from the business. A frustrated Lore then raised the subject with her son, Alvin, who worked side by side with his parents in the family business. Alvin responded similarly to his father and warned his mother that she was becoming paranoid.

Near the end of each year, the Levis met with their accountant to discuss various matters, principally taxation issues. The Levis placed considerable trust in the CPA who served as their accountant; for years he had given them solid, professional advice on a wide range of accounting and business matters. It was only natural for Lore to confide in the accountant about her suspicions regarding Betty the cashier. The accountant listened intently to Lore and then commented that he had noticed occasional shortages in the cash receipts records that seemed larger than normal for a small retail business. Despite Julius's protestations that Betty could not be responsible for any cash shortages, the accountant encouraged the Levis to closely monitor her work.

Embezzlements are often discovered by luck rather than by design. So it was with the Howard Street Jewelers. Nearly two years after Lore Levi had suggested that Betty might be stealing from the business, a customer approached the cash register and told Alvin Levi that she wanted to make a payment on a layaway item. Alvin, who was working the cash register because it was Betty's day off, searched the file of layaway sales tickets and the daily sales records but found no trace of the customer's layaway purchase. Finally, he apologized and asked the customer to return the next day when Betty would be back at work.

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1. Most of the facts of this case were reconstructed from information included in several legal opinions. The following two articles served as additional sources for this case: *Securities Regulation and Law Report*, "Accounting & Disclosure: Accounting Briefs," Vol. 23, No. 21 (24 May 1991), 814; *Securities Regulation and Law Report*, "Accounting & Disclosure: Accounting Briefs," Vol. 24, No. 19 (8 May 1992), 708.

The following day, Alvin told Betty that he was unable to find the layaway sales ticket. Betty expressed surprise and said she would search for the ticket herself. Within a few minutes, Betty approached Alvin, waving the sales ticket in her hand. Alvin was stumped. He had searched the layaway sales file several times and simply could not accept Betty's explanation that the missing ticket had been there all along. Suspicious, as well, was the fact that the sale had not been recorded in the sales records–a simple oversight, Betty had explained.

As Alvin returned to his work, a troubling and sickening sensation settled into the pit of his stomach. Over the next several weeks, Alvin studied the daily sales and cash receipts records. He soon realized that his mother had been right all along. Betty, the trusted, reliable, longtime cashier of the Howard Street Jewelers, was stealing from the business. The estimated embezzlement loss suffered by Howard Street Jewelers over the term of Betty's employment approached $350,000.

Questions

1. Identify the internal control concepts that the Levis overlooked or ignored.
2. When Lore Levi informed the CPA of her suspicions regarding Betty, what responsibilities, if any, did the CPA have to pursue this matter? Alternately, assume that, in addition to preparing tax returns for Howard Street Jewelers, the CPA (a) *audited* the business's annual financial statements, (b) *reviewed* the annual financial statements, and (c) *compiled* the annual financial statements.
3. Assume that you have a small CPA firm and have been contacted by a husband and wife, John and Myrna Trubey, who are in the final stages of negotiating to purchase a local jewelry store. John will prepare jewelry settings, size jewelry for customers, and perform related tasks, while Myrna will be the head salesclerk. The Trubeys intend to retain four of the current employees of the jewelry store–two salesclerks, a cashier, and a college student who cleans the store, runs errands, and does various other odd jobs. They inform you that the average inventory of the jewelry store is $200,000 and that annual sales average $800,000, 30 percent of which occur in the six weeks prior to Christmas.

   The Trubeys are interested in retaining you as their accountant should they purchase the store. They know little about accounting and have no prior experience as business owners. They would require assistance in establishing an accounting system, monthly financial statements for internal use, annual financial statements to be submitted to their banker, and all necessary tax returns. John and Myrna are particularly concerned about control issues–given the dollar value of inventory that will be on hand in the store and the significant amount of cash receipts that will be processed daily.

   You see this as an excellent opportunity to acquire a good client. However, you have not had a chance to prepare for your meeting with the Trubeys because they came in without an appointment. You do not want to ask them to come back later, since that may encourage them to check out your competitor across the street.

   Required: Provide the Trubeys with an overview of the key internal control issues they will face in operating a jewelry store. In your overview, identify at least five control activities you believe they should implement if they acquire the store. You have never had a jewelry store as a client, but you have several small retail clients. Attempt to impress the Trubeys with your understanding of internal control issues for small retail businesses.

CASE 3.3

Buranello's Ristorante

In 1983, Marta Giordano inherited the restaurant that her grandfather, Alberto Buranello, had established shortly after returning to his hometown of Boston after serving in World War I.[1] For nearly a century, the restaurant, Buranello's Ristorante, has been a landmark and favorite gathering spot for generations of families in Boston's historic North End neighborhood.

Over the years, the large corner restaurant that has a staff of approximately 40 employees, most of whom are part-time workers, has been essentially recession-proof. But Giordano's business recently faced two major challenges. Three local, formerly family-owned restaurants that Giordano considers to be her primary competitors were purchased by private investors who then renovated their interiors and facades and refurbished their kitchens. Although Buranello's breakfast and lunchtime traffic were largely unaffected by the competitors' upgrades, its dinner traffic fell by 20 percent. Making matters worse for Giordano during this same time span was another problem that was plaguing the restaurant, namely, abnormally large cash shortages apparently resulting from employee theft. These shortages were typically discovered at the close of business when the daily sales reconciliation worksheet was prepared.

The Suspect

Michael Barnes, Buranello's general manager, was just as frustrated by the cash shortages as his boss, Marta Giordano. Barnes has worked at Buranello's for more than 20 years and is practically a member of the Giordano family. His first position with the restaurant was as a busboy when he was 14-years-old. During college he worked as a waiter at the restaurant. When he graduated from Northeastern University with a management degree, Barnes turned down an offer from Giordano to become a member of Buranello's management staff, choosing instead to work for a large, nationally franchised restaurant chain that had an extensive management trainee program. Five years later, though, Barnes returned to Buranello's when Giordano offered him the position of general manager.

Barnes eventually called a meeting of the restaurant's management staff–himself, three shift managers, three assistant managers, and the chef–to address the cash shortages being experienced by Buranello's. At the meeting, which Giordano also attended, Barnes informed his subordinates that the cash shortages were becoming larger and more frequent. He pledged that he would catch the culprit or culprits and prosecute them to the fullest extent of the law. Barnes did not discuss specific measures that he planned to take to determine the source of the cash shortages. Why? Because he suspected that the thief was a member of the management staff. The prime suspect in Barnes mind was Aaron O'Neil, one of the three shift managers.

Barnes rotates the work assignments for the shift managers so that each of them works the closing shift, which is 3 P.M. to 11 P.M., only twice per week.[2] Buranello's

1. This case was developed from a recent legal opinion. The names of the actual parties involved in the case and the location have been changed. In addition, certain of the background details presented in the case are fictionalized accounts of information disclosed in the legal opinion.

2. The opening shift runs from 7 A.M. to 3 P.M. Shift managers supervise four eight-hour shifts each week. During their fifth eight-hour shift each week, they serve as an assistant manager to the shift manager on duty.

is closed on Sundays when it often hosts private parties such as family reunions and wedding receptions. One of the responsibilities of the shift manager at closing is to prepare the daily sales reconciliation. To perform this task the shift manager completes one of the standard reconciliation templates used for that purpose within the restaurant industry. The final task of the closing shift manager is to prepare the bank deposit for that day's sales. The day's receipts along with the completed deposit slip are left overnight in the restaurant's safe. The following morning, the shift manager who opens the restaurant recounts the receipts, traces the resulting total to the deposit slip, and then takes both to Buranello's bank a few blocks away.

The purpose of the daily sales reconciliation is to reconcile the day's sales reflected by the cash register printout to the total cash and cash items in the cash register at the close of business. The final line item on the reconciliation worksheet is entitled "Variance." A negative variance reflects a cash shortage, while a positive variance indicates a cash overage. Similar to most restaurants and retail businesses, Buranello's typically has a modest cash shortage at the end of each business day.

After Buranello's began experiencing abnormally large cash shortages, Barnes retained the business's accounting firm to analyze the restaurant's daily sales reconciliations. The accounting firm attempted to correlate the cash shortages with the shifts worked by the management staff and the cashiers, but the results of that analysis were inconclusive.[3] The accounting firm also attempted to determine whether the cash shortages were correlated with the presence of a specific shift manager during the closing shifts–Barnes believed that cash was most likely being stolen during the nightly closing procedures. Again, the results were inconclusive. There was no definite trend that linked the shortages to the closing shifts worked by specific shift managers. In Barnes's mind, the results of the accounting firm's analyses suggested that the thief or thieves were sufficiently clever to make it difficult for the cash shortages to be traced directly to them.

The only evidence that linked Aaron O'Neil to the cash shortages was the fact that they began occurring within a few weeks of the date that he began working at Buranello's. But there was another reason that Barnes suspected O'Neil. During the 20 years prior to accepting a position with Buranello's, O'Neil had been employed by seven different restaurants or restaurant chains. That unstable employment history had concerned Barnes when he interviewed him. The reference letters provided by O'Neil's former employers had also posed some degree of concern since they had been generally lukewarm, at best, in their endorsement of him. Despite the fact that O'Neil had been a marginal job candidate, Barnes had hired him because Buranello's management team was chronically understaffed. Similar to most restaurants, management and employee turnover is a constant problem faced by Buranello's.

The Opportunity

The cash shortages infuriated Barnes not only because of the adverse financial impact they had on the restaurant but also because they reflected poorly on his management style and overall performance as the caretaker of the business for the Giordano family. Barnes much prefers "pressing the flesh" with customers and the restaurant's wait staff rather than taking care of his back office responsibilities. He often allows his paperwork, which includes health inspection reports, tax reporting schedules, and the daily sales reconciliation worksheets, to pile up on his desk.

3. Five individuals have access to Buranello's cash register during each shift: the cashier, the shift manager, the assistant manager, Barnes, and Giordano, who typically spends a few hours each day in the restaurant.

Barnes finds the daily sales reconciliation worksheets particularly wearisome. He would never admit as much to Marta Giordano or any of his subordinates, but even after having completed hundreds of daily sales reconciliations, it is still a challenging task for him on the infrequent occasions when he closes the restaurant.

The objective of a daily sales reconciliation is obvious to Barnes, but the task itself is tedious and frustrating. The process of completing the worksheet at the end of a busy day requires properly analyzing a wide array of nonstandard transactions. These items may include a variety of coupons redeemed by customers, discounted meals purchased by employees, unpaid meal tickets of "deadbeat" customers who slipped out of the restaurant without paying, duplicate meal tickets issued to replace lost or misplaced tickets, refunds for overcharges, purchases or redemptions of meal cards given as gifts, petty cash expenditures such as modest charitable contributions, discounts or rain checks given to unhappy patrons whose pasta was not cooked to order, and so on and so forth. Each time that he completes a daily sales reconciliation worksheet, Barnes is reminded why he switched his major from accounting to management during his sophomore year of college.

Barnes also finds the task of reviewing completed daily sales reconciliation worksheets unpleasant, which is why he often has a stack of them sitting on his desk. Ironically, despite his accounting "dyslexia," he is the person responsible for the final approval of the reconciliations. The most challenging facet of reviewing the reconciliations is deciphering, comprehending, and then clearing the numerous comments printed or scrawled haphazardly in the margins of the worksheet form. On a typical day, there are six to eight "problem" reconciling items that the closing shift manager must explain in a written comment on the worksheet form–the template used by Buranello's does not have a "comments" section.

The intricate nature of the reconciliation worksheets has convinced Barnes that an unscrupulous shift manager could easily use them as a tool to conceal amounts embezzled from the daily sales receipts. This ever-present opportunity, if not invitation, to steal from the restaurant means that the larger than normal cash shortages recently experienced by Buranello's may have been significantly understated.

The Sting

The day following the management meeting in which he addressed Buranello's recurring cash shortages, Barnes met with Marta Giordano. He had developed a plan to address the problem, and he wanted her approval before he went forward with it. Barnes told Giordano that he wanted to carry out a "sting" operation to test the honesty of Aaron O'Neil–Giordano was aware that Barnes considered O'Neil to be the most likely source of the cash shortages.

The plan called for Barnes to replace the closing shift manager on an evening before O'Neil was scheduled to open the restaurant the following day. During the closing procedures, Barnes would prepare a deposit slip that understated the amount of cash receipts by several hundred dollars–Giordano would be present to verify the understatement. Barnes expected, actually hoped, that O'Neil would steal the excess cash prior to making the morning bank deposit. Barnes then planned to contact the police and file theft charges against O'Neil. Giordano reluctantly approved Barnes's plan, although she thought it smacked of entrapment and considered it to be distasteful.

Barnes executed his plan the following week and it seemed to work to perfection. Neither O'Neil nor the bank reported the difference between the cash receipts and the dollar amount reflected on the given deposit slip. In Barnes's mind that meant that O'Neil had stolen the excess cash in the deposit, which amounted to $360.

The following day, Barnes contacted the police and reported the incident. He and Giordano met the police detective assigned to investigate the apparent embezzlement. Barnes told the officer that he believed O'Neil had stolen the $360 and wanted to press charges against him on behalf of Buranello's. Barnes also told the detective that he suspected O'Neil was responsible for the rash of abnormally large cash shortages experienced by the restaurant over the past several months. The detective informed Barnes that it would be necessary for him to provide evidence to support that allegation.

That afternoon, the detective went to O'Neil's apartment with two uniformed officers–O'Neil had not been scheduled to work that day. After the detective explained the circumstances of the alleged embezzlement, O'Neil indicated that he wanted to contact his attorney. The uniformed officers then arrested O'Neil, handcuffed him, and marched him through the large courtyard of his apartment complex on the way to the patrol car.

O'Neil's attorney arrived at the police station to consult with his client later that afternoon. At approximately 5 P.M., the attorney arranged a meeting involving himself, O'Neil, and the detective in charge of the case. During this meeting, the attorney told the detective that O'Neil had not stolen the $360. When counting the cash before making the deposit, O'Neil had discovered that the cash receipts exceeded the amount reported on the deposit slip by $360. O'Neil had then taken that amount and placed it in Buranello's safe in an envelope marked to the attention of Michael Barnes.

The detective telephoned Michael Barnes, passed along the information provided by O'Neil, and asked him to search the safe. Barnes and Giordano went through the safe but could not find the envelope. When the detective told O'Neil that the envelope could not be found, O'Neil asked to be taken to the restaurant to search for it himself. The detective refused to do that.

O'Neil then asked the detective to send a police officer to search the safe. After the detective agreed to send an officer to the restaurant, O'Neil told the detective exactly where the envelope containing the $360 could be found. According to O'Neil, he had placed the letter-sized envelope containing the $360 in a larger envelope that was labeled "Equipment Leases." When the detective asked O'Neil why he had hidden the cash so well, he replied that he believed he was being "set up" by Barnes. O'Neil explained that he had been hoping to "buy some time" to figure out exactly what to do, which also explained why he had not called Barnes immediately and reported the excess cash.

The police officer sent to Buranello's found the hidden cash in a matter of minutes. The charges filed against O'Neil were immediately dropped, and he was released from police custody.

The Lawsuit

Aaron O'Neil never returned to Buranello's, choosing instead to resign immediately, but Michael Barnes and Marta Giordano had not heard the last of him.[4] One month later, O'Neil filed a "malicious prosecution" civil lawsuit that named Buranello's, Barnes, and Giordano as defendants. Following a brief trial, the jury ruled in O'Neil's favor and awarded him a judgment of $66,000. The defendants immediately appealed the jury's ruling. One year later, an appellate court overturned the jury's decision and voided the judgment. The appellate court ruled that because Barnes and Giordano

4. The abnormally large cash shortages experienced by Buranello's ended abruptly when O'Neil terminated his employment.