

Dilemma at Ground Zero – 2022 Menconi Case Competition Winner



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Michael Fore, J.D.

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Q&A

Asking Questions



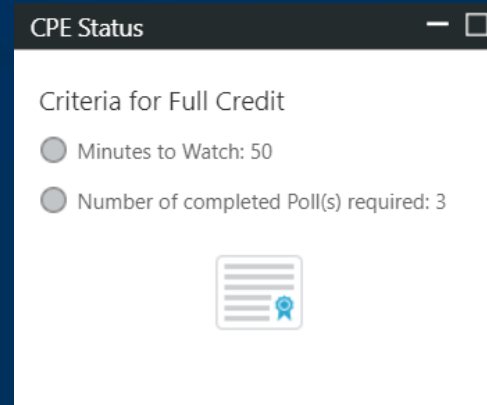
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Featured Presenter

Sarah Feltus, Ph.D., CPA
Assistant Professor
College of Business,
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Sarah Feltus's Biography

- Sarah Feltus has taught Accounting at Eastern Kentucky University for the last 7 years, including Auditing, Governmental Accounting, and Introduction to Financial Accounting.
- Before that, she worked as a financial auditor for the state of Kentucky for several years. Her work involved auditing state and local governments both in financial aspects as well as compliance with laws and regulations.

Featured Presenter

Michael Fore, J.D.
Assistant Professor
College of Business,
Eastern Kentucky University



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Michael Fore's Biography

- Michael Fore is an Assistant Professor of Management at Eastern Kentucky University, teaching Business Law and Ethics. Michael is a partner in the Richmond, Kentucky firm of Simons & Fore, PSC, where his practice focuses on civil litigation, business law, estates, and insurance matters.
- He is a past President of the Madison County Bar Association and has worked with various community organizations and nonprofit causes.
- Mr. Fore graduated from Tulane University in 1999 with degrees in both Political Science and History. In 2002, he obtained his Juris Doctor from Wake Forest University School of Law. He was admitted to the Kentucky Bar in 2002 and to the U.S. District Court for the Eastern District of Kentucky in 2003.

Featured Presenter

Justin (JP) Stearns, Ph.D., CMA, CPA

Assistant Professor

College of Business,
Eastern Kentucky University



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Justin (JP) Stearns's Biography

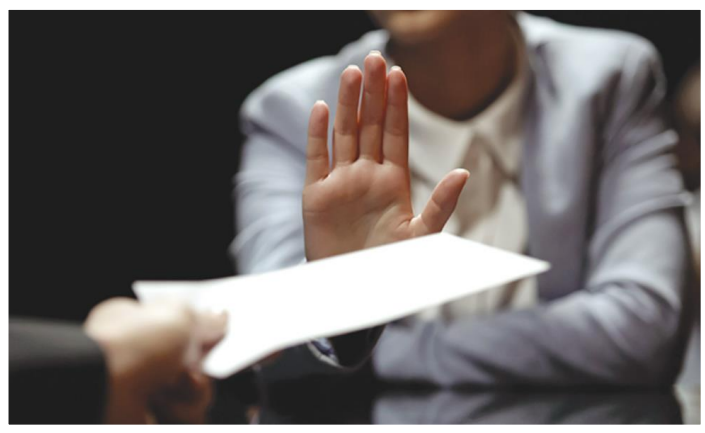
- Professor Stearns primarily teaches cost and managerial accounting at Eastern Kentucky University. His research interests center around judgment and decision making in the planning and budgeting process.
- JP is an active member of the IMA, currently serving as president of the Bluegrass Area IMA Chapter and as a faculty member in IMA's Leadership Academy. Stearns earned his doctorate in 2012 from Southern Illinois University at Carbondale.
- JP enjoys the hiking in beautiful eastern Kentucky and taking in as much baseball as he can in the summer.

Learning Objectives

1. Apply the “Dilemma at Ground Zero” case study for teaching.
2. Give examples of multiple ethical frameworks that can be used to evaluate an ethical dilemma.
3. Describe how to lead a discussion on performance evaluation in an investment center and the ethics related to performance evaluation metrics.

“How Ethics and Compliance Fight Corruption”

By Eugene Kornilovich, CMA



Winner of the Third Annual Curt Verschoor Ethics Feature of the Year Award

<https://sfmagazine.com/post-entry/march-2022-call-for-ethics-papers/>

Dilemma at Ground Zero

2022 Carl Menconi Case Competition Winner

Agenda

1. Introduction
2. Overview of “Dilemma at Ground Zero”
3. Ethical Frameworks
4. Investment Centers and Performance Management
5. Conclusion
6. Key take away



Motivation

- A more challenging ethics case study
 - A sympathetic antagonist
 - A scenario which challenged students
- A case study on a less covered topic
- Inspiration from true fraud case
- Create relatable case around type of dilemma students could face early in career



Overview of Ground Zero Case – The Players

- **Isabella** – recent graduate, protagonist, district accountant for Knoxville, TN district
- **Will D. Brewster** – co-founder of Ground Zero, leads philanthropic endeavors, district manager over Knoxville, TN, overseeing development of mail-order coffee initiative
- **Cassandra Ziegler** – Ground Zero CEO, co-founder
- **Gabriel Gecko** – Ground Zero Controller



Overview of Ground Zero Case – The Company

- Ground Zero (GZ) provides outsourced coffee service to company break rooms
 - Based on real company
 - For monthly fee provides high-end coffee maker/grinder, services equipment, and restocks coffee/creamers/sugar/snacks every week
 - Supplies fair trade Guatemalan coffee roasted with GZ's proprietary blend developed by Will D. Brewster
- Proud culture of philanthropy and caring for employees and community
 - Brewster leads philanthropic efforts in Guatemala
 - Employees led several efforts to support other employees in need and their communities



Overview of Ground Zero Case - Incentives

- District managers have 40% of compensation “at risk” and dependent on hitting quarterly ROI targets
- Ziegler family believes in challenging incentives, so district managers feel ownership interest in business



Poll Question 1:

How would you evaluate Ground Zero's compensation system?

- a. Good, more compensation at risk prompts more motivation
- b. Bad, putting too much pressure on managers to hit quarterly ROI
- c. Unsure, there are plusses and minuses
- d. Something else

Poll Question 1 Results: (Placeholder)

Overview of Ground Zero Case – The Story

- Isabella started new position after graduating as district accountant for Ground Zero in Knoxville, TN
- Alerted that district manager Will D. Brewster had recently suffered family tragedy
 - Wife and children were in a major automobile accident
 - Medical bills and legal costs had decimated family finances
 - GZ employees had raised thousands for family, but still difficult for Brewsters
- Isabella sees Knoxville had just barely met quarterly ROI targets last two quarters



Overview of Ground Zero Case – The Discovery

- Isabella discovers Brewster had discontinued multiple vendor contracts and taken on the work himself (with help from his family)
 - Fleet maintenance (oil change) and facility cleaning
 - Kept records and appears to have done the work
 - Charged GZ less than other vendors
- Had not gotten approval from leadership to contract with himself
- Reduced costs had allowed Knoxville to hit ROI targets
- ROI targets had become challenging with asset increase tied to mail-order division development
- Brewster also developed snack bar with Guatemalan farmers which he is selling to GZ divisions and had developed at GZ facilities



Teaching the Case - Incentives

- GZ districts are run as investment centers
 - Managers responsible for asset investment and earning profit
 - Managers have control of asset investment
- Calculations for ROI and RI straight forward
- Discuss intentions behind the GZ incentive system and how it may have contributed to Brewster's actions
- Discuss challenges in calculating asset base for ROI calculation
- Discuss proper performance evaluation approach for Knoxville district and mail-order district

The image shows a chalkboard with handwritten mathematical derivations illustrating the geometric interpretation of the derivative. On the left, a graph shows a curve $y = g(x)$ and a point $x+h$ on the x-axis. A tangent line is drawn at the point $(x, g(x))$, and a secant line is drawn through the points $(x, g(x))$ and $(x+h, g(x+h))$. The slope of the secant line is labeled $\frac{g(x+h) - g(x)}{h}$. The slope of the tangent line is labeled $f'(x)$. The derivative is defined as the limit of the slope of the secant lines as h approaches 0:

$$f'(x) = \lim_{h \rightarrow 0} \frac{f(x+h) - f(x)}{h}$$

The derivative is then calculated for the function $f(x) = x^2$:

$$\begin{aligned} f(x) &= \lim_{h \rightarrow 0} \frac{(x+h)^2 - x^2}{h} \\ &= \lim_{h \rightarrow 0} \frac{x^2 + 2xh + h^2 - x^2}{h} \\ &= \lim_{h \rightarrow 0} \frac{2xh + h^2}{h} \\ &= \lim_{h \rightarrow 0} (2x + h) \\ &= 2x \end{aligned}$$

The final result is $f'(x) = 2x$.

Teaching the Case – Internal Controls

- Recognize elements of fraud triangle
 - Pressure
 - Opportunity
 - Rationalization
- Identify internal control failures/weaknesses that enabled Brewster's deception
- Is this fraud? Is it a crime?
- Is there collusion?
- The snack bar issue?



Poll Question 2:

How would you rate Ground Zero's internal control system?

- a. Effective
- b. Typical
- c. Ineffective
- d. What internal controls?

Poll Question 2 Results: (Placeholder)

Teaching the Case - Ethics

- What is Isabella's responsibility according to IMA Statement of Ethical professional practice?
- What is an ethical response by GZ leadership to Brewster's actions?
 - Who are relevant stakeholders to this decision?
 - What are consequences of different approaches to decision?
- Has GZ been ethical in its approach to evaluating and rewarding Brewster?
 - Is GZ's ROI calculation appropriate?
 - Is GZ's response to Brewster's circumstance in alignment with professed corporate values?



Integrating Ethical Frameworks

Why include ethical frameworks?

- Too often ethics is presented as compliance
 - Focus on professional ethical standards
 - Little focus on ethical reasoning
- Practice applied ethics
 - Normative ethics and development of moral framework
 - Different frameworks can lead to different determinations of what is the ethical response to a dilemma



Ethical Frameworks

- Utilitarianism
 - Consequentialist approach
 - Greatest net utility determines ethical response
- Deontology/Kant
 - Rights/Duty to individuals
 - Ethical imperatives
 - Could rule be made universal
 - Treat people as an end, not as a means
- Virtue Ethics/Aristotle
 - Articulated list of virtues
 - Ethicality determined by how decision aligns with virtues



Applying Ethical Framework - Utilitarianism

- What produces greatest net good?
- Consequences of terminating Brewster
 - Brewster family faces financial ruin
 - Significant harm to GZ philanthropic efforts
 - Significant harm to GZ business
 - Key intellectual capital
 - Negative publicity and loss of customers
- Consequences of lighter sanction
 - Precedent being set with sanction
 - Negative utility for vendors affected



Applying Ethical Framework - Deontology

- What principles treat people as ends not means?
- What is owed to:
 - GZ owners/creditors
 - Brewster
 - Other employees/stakeholders
 - Affected vendors
 - Individuals involved in philanthropic endeavors



Applying Ethical Framework – Virtue Ethics

- What are GZ's guiding virtues?
 - For profit business
 - Philanthropy
 - To community
 - To employees
- How can GZ management apply these virtues to addressing the Brewster situation?
- Does the current incentive structure, applied to Knoxville district, align with GZ's virtues?



Poll Question 3:

Assuming work was actually done, was there an ethical violation committed here?

- a. Yes
- b. No
- c. Unsure
- d. Something else

Poll Question 3 Results: (Placeholder)

Investment Centers

Responsibility Centers

- Types of responsibility centers
 - Revenue
 - Cost
 - Profit
 - Investment
- Core foci for investment center managers
 - Generate profits
 - Utilize asset investment efficiently



Investment Center Discussion

- What is the intention behind the metric?
 - What behaviors are desired from the manager?
 - How does this metric incentivize goal congruency?
- Breaking down ROI
 - Du Pont Analysis
 - $ROI = \text{Profit Margin} * \text{Asset Turnover}$
 - Finance uses slightly expanded version
 - Are the components measured correctly?
 - Profit accurately calculated for evaluation purposes
 - Investment correctly calculated



Investment Challenges at Ground Zero

- Knoxville division added substantial assets without corresponding revenue increase
 - Raised bar for meeting ROI target
 - Drove down Asset Turnover markedly
- Should mail order division assets have been included in Brewster's evaluation?
- What would be proper metrics for evaluation of mail order division?



Summary Income Statement Data (figures in '00s)				
		2XX1 Q4	2XX1 Q1	2XX2 Q2
Revenues				
	Coffee Service	2100	2150	2175
	Snack Sales	400	450	475
Total Revenues		2500	2600	2650
Cost of Goods Sold				
	Coffee Service	1260	1290	1305
	Snack Sales	300	340	355
Total Cost of Goods Sold		1560	1630	1660
Gross Profit		940	970	990
Operating Costs				
	Wages & Salaries	350	335	330
	Contract Services	125	120	120
	Depreciation	15	25	27
	Supplies	30	28	27
	Other	25	23	22
Total Operating Costs		545	531	526
Operating Income		395	439	464

Assets Committed to Knoxville Division				
		2XX1 Q4	2XX1 Q1	2XX2 Q2
Current Assets				
	Cash	25	25	25
	Accounts Receivable	725	730	740
	Inventory	455	460	470
Total Current Assets		1205	1215	1235
Fixed Assets (net Depr)				
	Building & Grounds	2500	2650	2800
	Equipment	1000	995	1050
	Mail Order Equipment		2400	2600
Total Fixed Assets (net Depr)		3500	6045	6450
Total Assets		4705	7260	7685

<u>Return on Investment [ROI]</u>			
	<u>2xx1 Q4</u>	<u>2XX2 Q1</u>	<u>2XX2 Q2</u>
<u>Operating Income</u>	<u>395</u>	<u>439</u>	<u>464</u>
<u>Total Revenues</u>	<u>2500</u>	<u>2600</u>	<u>2650</u>
<u>Profit Margin (Oper Inc/Tot Rev)</u>	<u>15.80%</u>	<u>16.88%</u>	<u>17.51%</u>
<u>Total Revenues</u>	<u>2500</u>	<u>2600</u>	<u>2650</u>
<u>Total Assets Committed</u>	<u>4705</u>	<u>7260</u>	<u>7685</u>
<u>Asset Turnover</u>	<u>.5314</u>	<u>.3581</u>	<u>.3448</u>
<u>ROI [Profit Margin & Asset Turnover]</u>	<u>8.40%</u>	<u>6.05%</u>	<u>6.04%</u>

<u>Residual Income</u>				
<u>Operating Income</u>		<u>395</u>	<u>439</u>	<u>464</u>
<u>Total Assets</u>		<u>4705</u>	<u>7260</u>	<u>7685</u>
<u>RI Charge [TA * ROI]</u>		<u>283</u>	<u>436</u>	<u>462</u>
<u>Residual Income [OI – RI Charge]</u>		<u>112</u>	<u>3</u>	<u>2</u>

<u>Return on Investment [ROI] w/o Mail Order</u>			
	<u>2xx1 Q3</u>	<u>2XX1 Q4</u>	<u>2XX2 Q1</u>
<u>Operating Income</u>	<u>395</u>	<u>439</u>	<u>464</u>
<u>Total Revenues</u>	<u>2500</u>	<u>2600</u>	<u>2650</u>
<u>Profit Margin (Oper Inc/Tot Rev)</u>	<u>15.80%</u>	<u>16.88%</u>	<u>17.51%</u>
<u>Total Revenues</u>	<u>2500</u>	<u>2600</u>	<u>2650</u>
<u>Total Assets Committed</u>	<u>4705</u>	<u>4860</u>	<u>5085</u>
<u>Asset Turnover</u>	<u>.5134</u>	<u>.5350</u>	<u>.5211</u>
<u>ROI [Profit Margin & Asset Turnover]</u>	<u>8.40%</u>	<u>9.03%</u>	<u>9.12%</u>

<u>Residual Income</u>				
<u>Operating Income</u>		<u>361</u>	<u>439</u>	<u>464</u>
<u>Total Assets</u>		<u>4705</u>	<u>4860</u>	<u>5085</u>
<u>RI Charge [TA * ROI]</u>		<u>283</u>	<u>292</u>	<u>306</u>
<u>Residual Income [OI – RI Charge]</u>		<u>112</u>	<u>147</u>	<u>158</u>

Poll Question 4:

How would you resolve the situation?

- a. Bring in law enforcement
- b. Fire the manager
- c. Some kind of sanction, but manager keeps his position
- d. Something else

Poll Question 4 Results: (Placeholder)

Questions and Answers



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Thank you to Our Featured Presenters!



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