CSA Industries, Inc.
Case Study

The CSA Industries case raises issues related to managed, fraudulent, and unethical financial reporting at middle management levels in divisionalized companies.

Assignment:

1. Read the entire CSA case.

2. Part 1 provides background information on CSA. Discuss all the items within their environment and culture that would lead you to believe they would have the problems they did? Did CSA set itself up to have problems?

3. Part's 2 and 3 describe two of CSA's operating divisions and some of the actions they were considering and actually took. For each division separately, list some of the actions of management and classify each one as either:

   a. An acceptable business practice
   b. Unethical
   c. Fraudulent

4. Read Parfet's article a few pages back on earnings management and subjectivity. What is your position on the topic? Is it acceptable to manage earnings down (make them more conservative) as opposed to up? Explain in 100-150 words.

5. On Page 7 of the case, Roger talks about "immateriality." How might this concept come into play in CSA's case? Before answering this question read through "SAB no. 99 Highlights" a few pages back.

I revised and updated this case which was originally published by the Harvard Business School in 1986 and entitled Graves Industries.

CSA Industries
Case Study

Part 1: Company Background

At the annual stockholders' meeting in April 2004, Harry Larson, chairman, CEO, and president of CSA announced the creation of a new division of CSA:

"Ever since the founding of CSA we have worked to be on the leading edge of technology, always seeking to create machines for the factory of the future. Today we are taking a large step into that future with the founding of the Flexible Manufacturing division. The world of computer-integrated manufacturing has become so big and complex that we have created a new division dedicated to that industry. Big steps like this don't come cheaply. In the next four years we will spend over $100 million in R&D alone for this division. You say this is a large risk, and I agree with you but the potential payoff is huge...

This new division fundamentally alters the way we look at CSA and what we view as our primary business. I have authorized a number if new programs designated to cut costs throughout the corporation and improve our profitability. We will continue to be the standard of excellence in our other businesses, but clearly our focus is on the future...

Company History

CSA was founded in the early 1920s as a manufacturer of industrial hardware and tooling. The company went public in 1946 and was listed in the New York Stock Exchange. The company experienced only modest growth until after World War II, but after the war their sales and profits grew tremendously. From 1946 until 2000 the corporation changed little except to branch out into other areas of hardware and tooling. In 1946 CSA started a small consumer products division to produce and sell tools and hardware to hardware distribution chains. This division was very successful and by 2000 sales had risen to $122 million. In 1958 a separate automotive division was founded by splitting out the automotive sections of the Consumer and Industrial divisions. In 1963 the corporation moved into marine hardware by acquiring the Lohnes Marine Hardware Company in New Hampshire.

In the 90s, Harry Larson recognized that flexible manufacturing was the wave of the future and that to be a part of it CSA would have to make some large investments. The company started by building numerically controlled tools in the Industrial division. This field is so complex, however, and the potential market was so large that in 2004 a new division was formed.

Organization

CSA uses a divisional organizational structure. The corporate headquarters, located in Boston consists of the principal officers and their small staffs. The operating divisions are relatively autonomous operating companies and division managers are directly responsible for the division's products and services. They also operate their own R&D facilities, manufacturing, and marketing operations. Division staff report directly to division mangers and have relatively weak "dotted line" relationships with the corporate staff.

Headquarters controls divisional performance by reviewing plans and budgets and by monitoring financial reports. If performance is in line with corporate financial goals, few inquiries are made into divisional operations, but if negative variances result, headquarters gives divisions a great deal of attention and pressure is applied to improve results. Formal reviews are held quarterly to discuss the actual results and the forecast for the year.

Harry Larson felt that is was very important for the corporation to maintain a steady growth because "that is what the stock market values." Thus, consistency and predictability are the watchwords. Surprises are to be avoided. One division president noted that, "There are only two things important in this company: profit and turning it in in a predictable fashion."

Profit Planning

Profit planning is done in two distinct cycles: strategic planning and budgeting. Strategic planning involves creative thinking about corporate strengths, weaknesses, opportunities, and threats in the next three-year period. The division managers are required to submit a narrative analysis of their business and plans, supported by summary numerical schedules. Presentations of the strategic plans are made to top management each year in August and September.

After the strategic plans are approved, the divisions begin working on their budgets. The budgets are expressed in terms of monthly income statements, cash flows, and balances sheets for the coming year. They are reviewed by top management and the board of directors in November and December. The budgets are considered a commitment of earnings and return on assets from division managers to the corporation and from the corporation to the board.

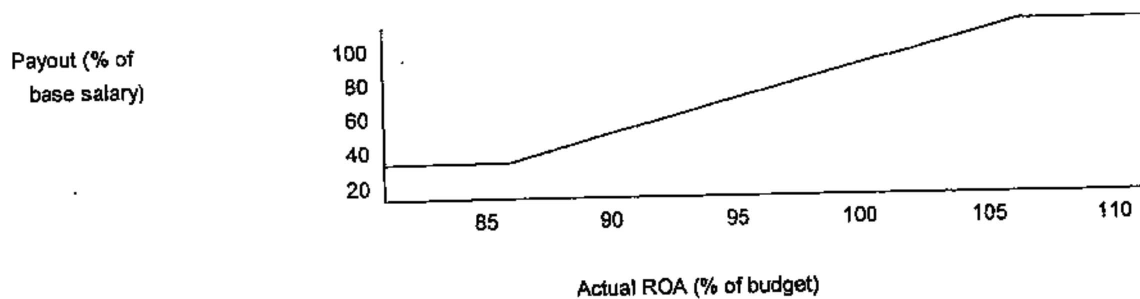
While the intent of the profit planning is "bottoms-up" it is typical for the division managers to have to adjust their targets after the review meetings. Harry Larson likes his managers to have aggressive budgets, and it was often said that "Harry always wants to take something from each division when he leaves the table."

Management Incentive Plan

CSA offers its management a base salary that was slightly below that if its competitors, and it relies on a Management Incentive Plan (MIP) to motivate and retain its key personnel. The MIP offers annual cash awards based on the actual vs. budgeted level of ROA achieved by the entity to which the individual was assigned.

About 60 employees were in the MIP, including most managers down to one level below division manager. The payouts in the plan are potentially lucrative. For example, the payouts for a division manager ranged up to 100% of salary, as shown below.

Management Incentive Plan Payout



No penalty below 85% and no extra reward above 105%

The incentive plan clearly attracted the attention of managers. In a survey done several years after the plan was implemented, the managers all reported that they understood how the plan worked and that it had a major affect on their decision making.

Board of Directors

The board consisted if five members, two inside directors (Harry and the president of the Industrial division, Steve Johnson), and three outside directors. The outside directors were all either active or retired executives who were long-time acquaintances of Harry. The board usually met four times a year to review the company's progress and future plans. The Audit Committee of the board consisted of the three outside directors. This committee was created in 1980 in response to a requirement of the SEC and the New York Stock Exchange for all publicly held companies to establish audit committees.

Internal Audit

The Internal Audit staff consisted of the head auditor and three staff members. The Internal Audit group ensured that corporate accounting policies were followed and verified that safeguards existed to protect company assets. They were also heavily involved with all Sarbanes-Oxley compliance. Their workload was heavy, and even though they were scheduled to visit each division once a year, sometimes they were able to perform audits only in alternative years.

Outside Auditors

Since 1988 CSA has used a Big Four accounting firm, Deloitte Touche. Harvey Krantz had been the partner on the CSA account for the last three years, and during that period Harvey and Harry Larson had developed an excellent working relationship. Socially, they were involved in many of the same activities, were members of the same country club, and occasionally played golf together.

In the past two years, however, the relationship had been strained as Larson applied pressure to reduce audit and tax fees. The growth of the new Manufacturing division created a need to free up dollars through cost cutting.

Part 2: Lohnes Marine Hardware Division

In January 2004, Don O'Malley, controller and financial officer of Lohnes, reviewed the financial results for 2003. Sales were up 12% and operating profits had increased 13%. Don knew that the division president, Paul Lohnes, would be very happy to see that the final figures were a couple of million dollars above budget. The company was also well positioned for a big jump on 2005's budgeted goals.

In contrast to 2003, the fourth quarter of 2004 had been relatively relaxed. Sales were strong throughout the year, and by the beginning of the last quarter the division had already achieved almost 90% of budgeted profits and sales. In 2003 the division had

only 68% of budgeted goals going into October, and it had taken a large effort by all employees to make sure the division finished on budget.

The stress of last year reinforced in Don's mind the advice he had received on his first job out of college. The controller of that company had told him when discussing accounting policies of his new employer, that "only a fool does not have a few reserves salted away for a rainy day." The reserves the Lohnes division built up had been very important in helping reach 2003 goals. But now Don wondered if the division reserves went beyond the bounds of reasonableness.

The Division

Lohnes Marine Hardware was founded in 1964 by Paul Lohnes. Paul was an avid sailboat builder in New Hampshire who became frustrated by poor support existing marine hardware companies were giving sailboat builders and owners. Paul reasoned that a full-service marine hardware and tooling business that provided special services for sailboaters could be highly successful. He also felt that as disposable income kept increasing in the U.S., boating would become increasingly popular, and the market would grow rapidly.

The Lohnes Company did very well. By 1970 the company was well established in New England, and Paul was looking at expanding into other regions. An important part of this success was the tools and marine rigging that Paul had originally designed and built for his own use that were now marketed by his company. The boating market was still young and growing, and Paul figured that if he could expand quickly and get a toehold across the country, he would be in good position to take a large share of the market. Paul had the knowledge, but lacked the financial resources to support a large expansion.

During the summer of 1971 Paul was approached by Harry Larson, Executive VP of CSA, a large producer and distributor of industrial and commercial hardware and tooling. Larson wanted to expand into marine hardware, but it did not have any experience in this specialized area and was looking for an acquisition.

At first Paul rejected CSA's offers, but in the fall of 1971 he reconsidered, and a deal was quickly hammered out. For an undisclosed sum of money, 100% interest in Lohnes Marine Hardware was transferred to CSA. This transfer included the name of the company, Lohnes Marine Hardware Company, and all the proprietary products manufactured by the firm. As part of the agreement, Paul was to remain as president of the new marine division.

One of the major reasons Paul agreed to the acquisition was CSA's decentralized management philosophy. The company would leave him in control of the Lohnes division with almost no corporate interference as long as results were at or above growth targets of 8% in sales and profits, and budgets were consistently achieved. Lohnes organization, personnel policies, and accounting systems would remain as they were before the acquisition. The only additional procedures required were a formal capital appropriation request and a monthly reporting of financial results to headquarters for consolidation. Corporate staff monitored division results and occasionally asked the division president or controller for explanations of budget variances.

The infusion of capital was just what the Lohnes Marine Hardware division needed, and sales grew from $4.1 million in 1971 to $88.4 million in 2002 – a compound growth rate of approximately 10.5%. The division almost always met its budget targets. The toughest years were during the 1974-75 energy crises which rocked the power boat industry. While the marine division did not make budget those years, it still remained profitable due to its strength in the sailboat segment of the business.

During his tenure with CSA, Paul realized that good performance, although well rewarded, was soon forgotten during the next fiscal year. Furthermore, because of the way the budget cycle and bonus program worked, an excellent year this year tended to make next year's goals even higher. This was not really much of a problem for the Marine division, however, as expanded production and a booming boat market caused it to be consistently among CSA's best performing units.

In the early 2004 the situation in CSA changed because of the formal formation of the Flexible Manufacturing Systems division within CSA. The FMS division had a R&D budget of $14 million in 1999 and this grew to $46 million in 2003, and the corporation was trying to fund this division internally by raising growth goals for the operating divisions and by instituting cost cutting programs. The new, more aggressive goals made management of the Lohnes division very difficult because the boating industry was still recovering from the recession in 2001-02.

2003

In late January 2003, Paul met with his new controller, Don O'Grady, to go over the division's financial condition and to consider plans for the future. Don pointed out that 2002 had been a relatively good year. Sales had reached $88.4 million, slightly in excess of the division's goal of $85 million. In addition the division had been able to maintain relatively large reserves where "a few nuts were stored away for a bad winter."

Paul said that was all well and good, but he was worried about future prospects, and he wanted to have more control over his reported sales and profits. He suggested a number of ways the increased control might happen. He told Don that when the division was having a good period he wanted to meet the assigned goals and then be very conservative in the accounting so as to have a good start on making the goals for the next period. For example, if the division was near its quarterly target, it would be good to declare a shipping moratorium for the last week or two of the quarter to shift some sales to the next quarter. He also suggested increasing the reserves taken against inventory, receivables and potential liabilities.

Paul said Don should meet with Patti Allen of Sales and Jack Nelan of Production and Purchasing to do some brainstorming for more ideas. He also told Don that the discussions should be discreet. Even though none of this was illegal, he did not want to cause any waves at headquarters. Don said he understood.

The year 2003 was surprisingly good and by mid-March the division had exceeded its quarterly sales goal. Patti Allen imposed a shipping moratorium for the last ten days of March, and $3.8 million in finished goods were held and shipped the first days of April. Even though she agreed with trying to smooth earnings, Patti did complain to Don and Paul that complete halts in shipping caused problems with work scheduling, product damage, and delayed deliveries to customers. Paul agreed there were costs associated with this shipment policy, but he felt they could be minimized.

Patti said she would like to be able to do some shipping to their large customers. She suggested that she could ship some large orders in the current quarter but ensure that they were not entered in the shipping log until April. She would date the invoices and the bills of lading for the beginning of the next quarter and hold them on her desk until the second week of the new quarter. She would then submit the invoices to the accounting department for processing as a new quarter sale and make the entries into the shipping log. In case any auditors asked why the invoices were out of order, she planned to tell them that the shipments had been held up for a brief time at the last minute.

In 2003 sales continued strong, and Patti's invoice-dating program allowed for smooth growth in quarterly earnings. On December 31, 2003 Patti held invoices for $7.4 million in goods to be "shipped" the first week of January.

Other company efforts to prepare for the unknown future included a buildup of obsolescence and bad debt reserves (a total of $900,000) and a new marketing expense program. This program, which was worked out between the Sales & Marketing department and the Marine division's advertising firm, allowed for the prepayment of part of the next year's marketing expenses. Rather than being booked as a prepaid expense, however, these expenses would appear in a bill from the ad agency which listed them as services for the current year. The division would then book them as an expense for the current period. The Sales & Marketing department kept a separate ledger to keep track of these expenditures to ensure that the paid for services were received. A total of $600,000 of 2004 advertising was paid for in 2003.

2004

The downturn started in 2004. Sales were very sluggish for the first two quarters. Paul and Don were somewhat worried but took no action other than maintaining pressure on Sales and Marketing. When the third quarter continued the slow trend, Don started to liquidate some of the reserves, and by the end of 2004, reserves were reduced by $1.8 million. The auditors questioned these changes in reserves, but Don and Paul gave them an explanation based on an analysis of changes in inventory composition and estimates of forthcoming bad debt losses and expenses. The auditors were skeptical, but they eventually concurred with the changes.

Another big step taken by the division was the establishment of the Early Order Program for distributors and larger boat builders. Those who ordered early (the end of 2004 instead of early 2005) received large discounts. This program also provided liberal credit terms. No payments were due for 90 days, and no late payment fees were assessed until 120 days after receipt of the shipment. Some of the more aggressive salespeople told their clients to "order the stuff now and don't worry about any payment dates. Just pay us when you sell it, and you get to pocket the extra margin." Although this was never formally sanctioned, a flurry of fourth quarter sales brought the year end results just above the budget goal of $108 million.

2005

The first quarter of 2005 was slow due to all of the early orders placed in 2004, but by the middle of the second quarter, sales had picked up dramatically. In fact third quarter results were so good that $4.7 million had to be "transferred" to the fourth quarter, and the Early Order Program of 2004 was suspended.

By the end of 2005 the company had not only passed all required goals, but also had a $10.4 million start on 2006 revenues, had restored $2.2 million in reserves, and had paid for $.8 million of 2006's advertising. Once again changing of the reserves was questioned, but the auditors accepted Don's explanation of "wanting to be conservative."

2006

Don knew the Lohnes division was well positioned for the new year, but he worried about where all this management of earnings would finally lead. He had hoped it would not continue, but the financial drains of the FMS division were growing, and he expected CSA to start pressing all of the other divisions even more. He also knew that Paul and Patti were already discussing new ways to smooth income, and Don wondered what he should do and whom he could speak to about this sensitive matter.

Part 3: Consumer Hardware Division

It was one week before Christmas in 2004 and Leo Gladue, the president of CSA's Consumer Hardware division, had just returned to his offices after a long and difficult budget meeting with Harry Larson. It had been a tough year for the Consumer division, and they had just barely made budget. Leo has argued that with the slowing economy the division could only expect growth of 3-4% in 2005, but Harry insisted that growth of at least 8% was possible. Leo resisted, but he gave in when Harry chided him for his lack of aspiration and questioned whether he had the vision necessary to manage the business.

As he sat in his office, Leo knew that possibly a lot more than just his bonus was riding on making the division's assigned goals for 2005. The growth of the new Flexible Manufacturing Systems division was affecting the whole corporation. The other divisions were being squeezed hard for profits so as to fund the FMS growth. Leo wondered if they were being squeezed too much.

Division History

The Consumer division was founded in 1946 to allow the company to branch out and use its large, wartime production capacity effectively. The division started out producing simple home tools that were sold through distributors. Realizing the CSA name could be a distinct advantage, the division's managers moved into producing a wide variety of high quality tools and hardware. The division developed a brand name image and sold through distributors to selected hardware chains.

The Consumer division experienced slow, steady growth until the mid-1950s, when Harry Larson took over as president. Harry had just returned from serving in the Navy, and he had some new ideas. He promoted the idea of "professional tools for the home mechanic" and pushed the safety and reliability of CSA products. He also expanded the product line and the distribution system in search of faster growth. He continued to find ways to grow and for the next 12 years the division enjoyed revenue growth at a compound rate of 12%.

In 1968 Harry was promoted to CEO. Leo Gladue, who had worked for CSA for 22 years in the Industrial and the Consumer Hardware divisions, was appointed as the next president of the Consumer division. Leo was well regarded for his technical knowledge and his ability to get along with the distributors, but his knowledge of finance and accounting was considered weak.

In the early 2000s the division's growth rate began to slow. Sales targets were getting harder to reach, and the startup of the FMS division only compounded the problem as the Consumer Hardware division was expected to continue to achieve CSA's long-term growth target of 8% per year.

Revenue Recognition

The Consumer Hardware division sold its goods to distributors who took title as soon as the orders were shipped. No goods were put on consignment, so sales revenue was recognized as the goods were loaded on a truck. As was the industry standard, the Consumer division did offer large discounts for distributors who placed large orders early, and they used a wide variety of seasonal promotions as needed to stimulate sales.

Every now and then the Consumer division had been known to load some of the trucks in their fleet at the end of a fiscal period to generate "sales in place." The loaded trucks would move a short distance from the dock and park until it was time to make their deliveries.

2004

The year 2004 was difficult for the Consumer division. The economy was beginning to slow and interest rates were relatively high which is the worst combination for a hardware and tool business. As midyear approached and predications for the annual sales numbers did not look good, Leo applied additional pressure to the Sales and Marketing department to "get more orders." Sales and Marketing responded with a plan that they implemented but kept secret. Tim Bonsaint and John Ahern were the only senior managers to know about the plan.

The Consumer division used approximately 30 distributors, but eight generated 75% of CSA's business. Tim and John's plan was to ship additional, unordered products to the large distributors. These unordered shipments would be rotated among the large distributors and sent out along with their regular orders near the end of the month. These extra shipments would then be recorded as revenue. Four methods were used to cause the unordered product to be shipped including: (1) re-entering a previously entered order, (2) doubling, tripling, or otherwise increasing the amount of product actually ordered, (3) creating fictitious orders on behalf of the distributors, and (4) shipping an unordered product when the product ordered was not in stock.

Once the unordered shipments were delivered, steps were taken to keep the goods from being returned or as least to delay their return. Overshipments were blamed on administrative and computer errors, and salespeople were directed to "make the sale stick" by (1) offering special prices or terms, (2) exchanging the goods for other Consumer division goods, (3) storing the goods at CSA's expense until needed, (4) arranging trades between distributors, and (5) ignoring the distributors' attempts to return the goods until the distributor had time to "digest" the shipment.

The plan worked well. Even though the amount of "returned goods" increased, the net effect was to increase revenues by $2.8 million and profits by $600,000.

A Planning Meeting

Leo Gladue, unaware of Tim and John's activities, scheduled a meeting for the second week in January 2005. He wanted has management team to review 2004 and start planning on where to come up with the additional sales required under the new budget for 2005.

The meeting was held on January 10, 2005. The first item in the agenda was a review of the 2004 results. The financial officer, John Ahern, reported that the level of sales had just come in over budget. Operating profits were close to budget, and after a few journal entries were made to reduce June reserves held against inventories and receivables, the operating profit and ROA targets would be met.

The next item was the most important one. They had to identify new sources of revenues and other areas of cost savings that would be necessary for meeting the new budget. The discussion went on for hours, but there were no clear solutions. When the meeting adjourned, Leo Gladue instructed all department heads to commence internal studies to identify potential revenue sources and cost savings.

Sales and Marketing

In the following week, the Sales and Marketing department decided to expand the overshipment program started at the end of 2004, and they further decided not to tell Leo about the specifics of the program. Tim Bonsaint, the head of Sales and Marketing, just promised Leo that through "selective discounts and promotions we will increase the average order size of our largest distributors." The actual size of the overshipments was to be carefully controlled by Tim, using forecasts of actual quantities and annual sales.

Production and Purchasing

The Production and Purchasing department could do little to help with new revenues, but its manager, Kimberly Colson, knew she could have a large impact on controlling the expenses of the company's contracts with its suppliers. Some of CSA's suppliers sold both machines and parts to the division, and it was possible to alter contracts to adjust the amount of the expenditures to be capitalized. For example, CSA had a contract with Riley Machine Company for $500,000. $200,000 of this amount was for two new ratchet machines, and the rest of the money was for 50,000 ratchet assemblies. By having Riley change the invoices to indicate that $300,000 was for the two machines, the price of the individual ratchet assemblies would drop by 33%. The extra $100,000 could be capitalized and expensed over the life of the machines, and the immediate effect was an increase in profit.

Kim knew many variations on this scheme, such as adding a special "tooling charge" to the reduced base price of the ratchet machines. This tooling charge could be capitalized by the Consumer division, the price of the machines would not have to be changed, and CSA would still get the ratchets assemblies at the reduced price. And by mixing methods, no clear pattern would emerge. Such a system could easily be run by Kim and a few of her purchasing people, so she told Leo that by putting pressure on suppliers, she had negotiated some price reductions on components.

2005 Results

The year 2005 was slow, and the Consumer Hardware division struggled, but with the assistance of the two special programs it was able to meet its quarterly targets. Managers in the Sales and Marketing department projected that by the end of the year they would have "overshipped" (after returns) a total of $8.9 million in goods that increased operating profits by $1.8 million. And Production and Purchasing managers were able to negotiate contracts that reduced current expenses by $2.7 million ($2.2 million after depreciation). Not all of this went completely unnoticed, however. Toward the end of the year Leo started to ask questions about the higher than normal returns, complaints from distributors, and capital expenditures.

The Auditors

The auditors also noticed. In the first week of December, Roger Sexauer, the manager assigned to the CSA audit, was sitting in his office when he received a phone call from Don Hubbard, the senior assigned to the audit of Consumer Hardware and Automotive divisions of CSA. The conversation went as follows:

Roger: Hello Don, what can I do for you?

Don: I am calling about the Consumer Hardware division audit. I have come across some unusual transactions, and I can't get any reasonable answers from the company's staff.

Roger: What's the problem?

Don: One of my staff accountants was performing a review of capital expenditures for this past year and found some things that don't seem right.

Roger: Like what?

Don: Large price hikes in what appears to be standard equipment for this division and an unusually large total of "tooling charges" and "tooling premiums."

Roger: Have you investigated the reason? Perhaps the equipment has been specially modified and, as a result, costs more. Also, this division has always had "tooling charges." For any special product they want produced, they help the supplier pay for the modifications to his equipment. Since this is a capital improvement, they can capitalize the portion that they pay for.

Don: I know that, but I have checked a lot of this equipment myself, and it all looks to be the same as the machines bought previously. When I ask people in Purchasing, they don't have a good answer. They say the differences are caused by inflation or some kind of internal modification. Now, as to the tooling charges, in 2004 they totaled $147,000. This year, through November, they totaled over $400,000.

Roger: That is a sharp increase. Perhaps they have made modifications to the parts in question and the supplier has billed them to cover their fixed investment.

Don: I don't think so because the parts don't look like they have changed. However, this leads me to what I think is the heart of the matter. Do you remember when we asked Kim Colson about the decrease in price on some of the parts they were purchasing?

Roger: Yes I do, and if I remember correctly, she said that since CSA had become such a large buyer for the output of some of their suppliers, she was able to negotiate large discounts. Also, she said something to the effect that the suppliers had made so many of the items that their cost of production per item had gone down significantly.

Don: That's right. But when you stand back and look at the whole situation, the suppliers that gave them the large discounts on parts are the same ones that either raised their prices on capital equipment and/or are charging them for tooling charges.

Roger: Now I see the picture. This is either an incredible coincidence or there is a systematic plan to capitalize current expenses and overstate profits.

Don: Right! Now comes the hard question -- what do I do now? Should I talk to the division's president now or wait for you to get here?

Roger: No, no! Keep on going with the audit, but be extra careful. If there is one problem like this there may be others. This division is under a lot of pressure to increase operating profits. What is the total impact of this on their bottom line?

Don: We are still working on this but it looks like about $1.7 million to $1.9 million for 2005, and it could be higher.

Roger: Well, that should only be about 4-5% of the division's operating profit and corporate net income. Right?

Don: As of right now that's correct, but if we find anything else it could go higher, especially if this has been going on for a couple of years.

Roger: That's true. Well, you push on there. I will talk to Harvey (audit partner of the job) and let him know what you've found. Then I'll meet you and look over what you've found. In the meantime don't say anything to anyone at the company till I get back to you.

Roger sat at his desk and thought about what Harvey would do if his suspicions were correct. The amount of money involved so far was large for the division, but perhaps immaterial from the standpoint of the entire corporation.

December 2005

In the middle of December, Tim and John, finding it increasingly difficult to keep their scheme going and virtually impossible to meet their 2005 targets, decided they had better be honest with Leo. They were sure that with his support they could lay out a convincing story for the events of 2005 and get the auditors off their back.

As they told the whole story, Leo sat dumbfounded. Shortly thereafter, Kim explained what she had been doing. Leo felt he had no choice to inform corporate headquarters and the external auditors immediately.