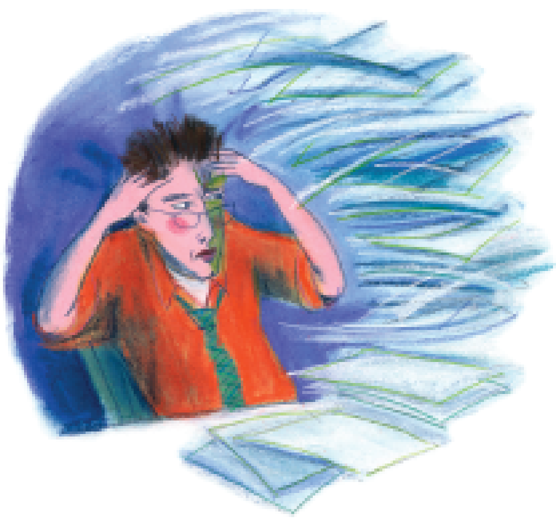
MEOU: This Co-op Scratches Rather than Purrs

By Cecily Raiborn, CMA, CPA, and Roselyn Morris, CPA

The Institute of Management Accountants (IMA®) Committee on Ethics and IMA Professor-in-Residence Raef Lawson, CMA, CPA, are proud to announce that Cecily Raiborn, CMA, CPA, and Roselyn Morris, CPA, have won the Best Case Award in the third annual Carl Menconi Case Writing Competition for their case, "MEOU: This Co-op Scratches Rather Than Purrs." The competition is named in memory of Carl Menconi, who held leadership positions in IMA for many years and served as chair of the IMA Committee on Ethics. The objective of the competition is to develop and distribute business ethics cases with specific application to management accounting and finance issues and that use IMA's *Statement of Ethical Professional Practice* as a reference or guidance tool. The winning case and teaching notes are available for use in a classroom or business setting.



Lee Marcos, CMA, CPA, has worked as chief accountant at Madison Electric Owners' Utility (MEOU) for three years. Marcos reports directly to Richard Barnett, MEOU's 67-year-old CEO and general manager, who is known for having an explosive temper. Marcos, however, is more concerned about some of MEOU's financial activities than he is by Barnett's iron-fisted management style. Barnett and MEOU's previous chief financial officer (CFO), John Blanchard, had been long-time friends. As such, they often communicated about the aspects of the accounting function on the golf course while Marcos was back at MEOU's headquarters—making Marcos feel a little "out of the loop." Since Blanchard's retirement in mid-2008, Marcos has begun to feel more comfortable with Barnett personally but less comfortable with him professionally. Recently, Barnett has begun to allow Marcos to perform some functions that Barnett and Blanchard had previously kept tight control over, such as budget preparation.

ILLUSTRATIONS: ANN BOYAJIAN/ARTVILLE

Background

Located in Canton, Miss., MEOU is a not-for-profit corporation serving approximately 200,000 customers in the rural areas of several mid-state counties. As an electric cooperative, MEOU employs about 700 people, is owned by the customers it serves, and sells power. MEOU doesn't generate any power itself; rather, it purchases power from other sources and distributes it over an MEOU-owned transmission and distribution system.

Utility cooperatives were started under Franklin Roosevelt's New Deal program as a way to supply customers who were otherwise not being served by investor-owned utilities. Customers in rural areas tend to be spread out, making the cost of installing and maintaining an infrastructure expensive for a power company, creating high per-unit costs. As customer-owned, nonprofit organizations, the co-ops could buy service in large quantities, distribute it to their owner-customers at "reasonable" prices, and pay no taxes. Any profits generated could be either returned to the owner-customers as capital credits (essentially dividends on members' investments) or reinvested for additional infrastructure.

MEOU has annual revenue of approximately $400 million and an asset base of approximately $1 billion. Over the years, it has placed around $150 million of revenues in excess of costs into an investment account directed by Clark Investments. MEOU has never used any of these investment funds for member distributions even though the co-op's bylaws state that all excess revenues and receipts must be returned to owner-members.

The Board

MEOU is managed by an eight-member Board of Directors, each of whom must be an owner-customer from a different MEOU county. All Board members are eligible to vote on organizational matters. With the exception of the Board president, Board members aren't paid salaries. They are supposed to be reimbursed a fixed per diem amount plus expenses for attending co-op meetings. A seven-member, nonvoting, unsalaried Advisory Board also exists. When preparing the budget for the upcoming year, Marcos had to calculate an amount for "Director/Advisory Board Expenses." Using actual figures from several prior years, Marcos realized that compensation for Board and Advisory Board members was averaging approximately $700 per hour for 50 to 200 hours per year.

Additionally, document review revealed that some funds were being paid for nursing home care for one of the past Board members. When Barnett was asked about these figures, he told Marcos to include these payments in the budget under "Health Care Benefit Costs." In the 1990s, MEOU's Board created (during a closed meeting) an "emeritus" program to provide, on a case-by-case basis, lifetime pay and benefits to directors after their service on the Board ended. Pay is calculated based on a formula related to years of service. Other co-ops commonly grant an emeritus title to retired Board members—but not pay.

The president of the Board of Directors is Billy Bob Williams. He has held that position for the past 25 years and has served on MEOU's Board for almost 40 years. According to co-op bylaws, the Board president is supposed to work a 40-hour week for annual pay of $1 million. Williams is a busy man, however, and doesn't put in normal work hours. He also doesn't have an office, any staff, a computer, e-mail, or voice mail at co-op headquarters in Canton. In fact, Williams once stated that he knew little about the co-op's operations, couldn't remember seeing the co-op's budgets, wasn't sure if there were any standing committees for the Board, and was unsure who, if anyone, approved director and executive expenses.

Other Personnel

The Board appointed Richard Barnett as the co-op's CEO and general manager. Like his friend Williams, Barnett has been in his position for 25 years. He has control over almost every aspect of MEOU, with virtually no oversight. For example, he has the unilateral authority to write checks for any amount without Board approval. Although Barnett's pay is required to be reported on Form 990, it rarely is. In 2007, Marcos insisted that a report be filed (for the first time in nine years). It showed Barnett's $400,000 salary, a deferred compensation package of $2 million (which owner-members were unaware of and half of which was withdrawn in cash in the following year), and a $400,000 "continuation bonus" that was paid to keep him from resigning when he turned 65. Barnett normally receives an annual six-week vacation. In 2007, however, he took an additional six-week, "no-call, no-contact sabbatical" from his job while receiving full pay.

Managers at MEOU typically earn annual salaries averaging $140,000. Co-op employees are required to keep specified hours, are commonly docked for tardiness, and don't telecommute. One manager, Allison Furth, was concurrently an MEOU manager and the CEO of a motivational speaking company (You Go Girl, Inc.). When Furth first began working for MEOU, she was typically seen in the Canton offices. After a while, however, she simply stopped showing up. Employees who questioned her whereabouts and activities were chastised; such inquiry was unacceptable in MEOU's operating environment—after all, she worked directly for Barnett! Furth received full pay and benefits during 2006-2008, and Marcos, who had never met Furth, noted that her salary was included in the 2009 budget.

The co-op's in-house attorney is Michael Clark. Clark's family has provided banking, legal, and insurance services to MEOU for several decades. In attempting to properly project the expenses for these services in 2009, Marcos searched the paid invoices files. He couldn't find any documentation on precisely what services had been performed, and a little additional research couldn't uncover any competitive bids for such services. In total, Clark's family's businesses received approximately $5 million during a 15-year period, as well as $20,000 per month for bad debt collection and $15,000 per month for Board secretarial services. Marcos noted that MEOU's bad debt write-offs were significantly higher than those of its peer group, and minutes for Board meetings were taken by Lily Finch, an MEOU employee who has worked at MEOU for almost 30 years. In fact, in the mid-1980s, the co-op purchased some acreage from Finch for $100,000. Budgeted 2009 property taxes included for that acreage were based on an appraisal amount of $70,000.

Company Work Environment

Barnett is known for implementing authoritarian business procedures. Two of Barnett's policies were to ban all employee e-mail and to allow voice mail only in emergency situations. Messages for employees were commonly placed in envelopes on a bulletin board above the time clock in the employee entrance foyer. Employees were told not to "bother" the human resources department. Although the employee handbook could be read online, no print feature was available so as "to conserve paper and reduce costs." Employees who wanted to talk with a manager were required to tell assistants how urgent the request was…but not why the manager was needed.

Through office discussion, employees communicated the basic rules of existence at MEOU: Don't make yourself noticeable; don't challenge management; don't antagonize anyone during meetings; and, above all, don't get on Barnett's "bad side." Employees who disregarded the rules were suddenly reassigned to locations far removed from their homes, demoted, or terminated. After all, Mississippi is an "employment at will" state.

Performance reviews are required for all of MEOU's rank-and-file employees. Such reviews, however, were never performed for Barnett. He reports directly to the Board, which apparently has had no criticism of his job execution.

Co-op employees were made aware of the need for frugality in the organization, but cost consciousness didn't extend to MEOU executives and Board members. Over a four-year period, several of those individuals charged a total of $1.5 million on company credit cards for first-class airline tickets and hotels, spouse travel, concert tickets, alcoholic beverages, and dry cleaning. For each year between 1998 and 2007, MEOU had the highest or second-highest operational expenses per customer compared to other large electric co-ops. In doing his budget preparation work, Marcos researched basic ratios and trends for electric co-ops. Most co-op information he found indicated that general and administrative (G&A) expenses declined as a percentage of total revenues as the co-op grew because of economies of scale and the ability to spread fixed costs over a larger customer base. In MEOU's case, however, G&A costs had more than tripled in 10 years to more than $400 million.

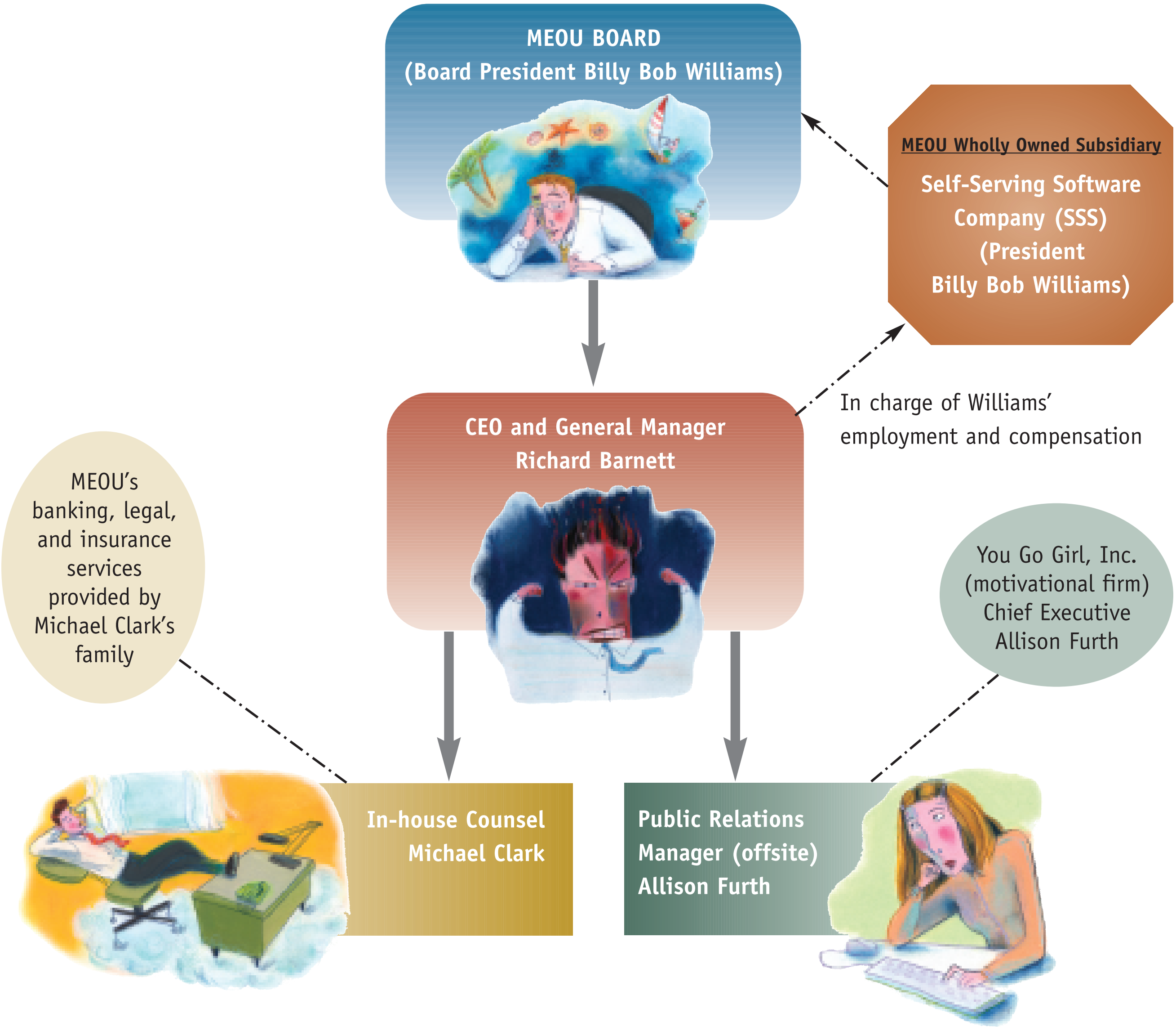
Software Subsidiary

To Marcos, one very unusual budget line item related to Self-Serving Software (SSS), the co-op's wholly owned software subsidiary based in Tennessee. SSS handles the co-op's billing software and had more than $14 million in losses between 2002 and 2008. MEOU had purchased SSS in 2001 for approximately $70 million; estimates for purchasing custom-designed co-op software at that time averaged $35 million. After the purchase, SSS transferred the software design costs to MEOU, which capitalized them. Typically, software created for a company's own use is expensed.

Efforts to sell billing software to other companies have been largely unsuccessful. Most potential customers found SSS's pricing structure too high. As a result, MEOU is the primary customer of SSS and responsible for approximately 80% of the company's revenues.

In 2004, MEOU spent $650,000 on a 7,500-square-foot headquarters building for SSS and its 20 employees. In 2005, MEOU decided some SSS employees were needed closer to headquarters, and records indicate that $1.2 million was spent on renovating a small facility in Fannin, Miss., for 13 additional SSS employees. One subcontractor who worked on that facility was overhead remarking to buddies, "How on earth could MEOU be spending $1.2 million on this job? All that's being done is moving some light fixtures, installing some new plumbing and

Figure 1: A Partial MEOU Organization Chart



dividing walls, and welding some steel. But, hey, I can't complain—I wish I had more jobs like this!"

As indicated in Figure 1, the president of SSS is none other than Billy Bob Williams, whose compensation and employment terms are set by Richard Barnett in his role as general manager of SSS's parent company, MEOU. Both Williams and Barnett have established second homes in Tennessee and make almost monthly trips to SSS at MEOU's expense.

Problems Begin

In mid-2008, the local Canton newspaper and MEOU's Board each received an anonymous letter claiming that Barnett had taken gambling trips to Atlantic City on MEOU's expense account. Incensed, Barnett obtained the Board's copy of the letter and had it dusted for fingerprints. He then ordered all of MEOU's managers to be fingerprinted, but the letter's author was never identified.

In late 2008, three individuals submitted their names as candidates to join MEOU's Board. Getting on MEOU's Board isn't an easy task. The process requires candidates to be approved by the seven-member nominations committee, which is appointed by the current Board. Potential candidates are allowed to make a 15-minute presentation to the Board in support of their candidacy. Needless to say, presentation to the Board doesn't guarantee concentration by the Board members. All three candidates noted that no Board member took any notes or asked any questions during the presentations. None of the candidates was asked to join the Board.

Although Mississippi has voted to institute sunshine (or open records) laws, the state isn't seen as very "information friendly," scoring only 41 out of 100 points (a grade of F) on the 2007 Better Government Association/National Freedom of Information Coalition assessment.[1] Even if Mississippi's government organizations were more transparent, it wouldn't make a significant difference because open records laws don't apply to electric co-ops. Several concerned owner-members managed to attend a few MEOU Board meetings and began asking questions about co-op operations. For example, in late 2008, owners raised questions during a Board meeting about Allison Furth's concurrent positions at MEOU and You Go Girl. The next day, Furth's name had been removed from the motivational speaking company's website, and she was seen at MEOU's headquarters.

In early 2009, allegations of wrongdoing by the Board and MEOU executives began to appear in local newspapers. The monthly Board meetings were inundated with angry co-op owner-members demanding financial information and changes in the executive ranks.

Two state lawmakers (living in counties served by MEOU) demanded that MEOU allow state auditors to have access to the co-op's financial records—an exceptionally unusual circumstance because state auditors typically investigate government entities, not private companies. The Board rebelled on that request, saying that MEOU's books had previously received clean audit opinions by external auditors. After much debate, the Board offered a compromise position: a secondary audit by a firm selected by the Board.

Owner-members weren't satisfied with the possibility of a "sanitized" audit and filed a lawsuit against MEOU, its Board, and several members of MEOU's management team. TransparenSee, Ltd., a Denver-based consulting firm, was engaged to conduct an investigation of the company. As it started uncovering more and more information, MEOU's operational and financial circumstances began to look and smell like a dirty litter box. Some of what TransparenSee brought to light includes widespread overpayment of certain employees and Board members, excessive reimbursed spending by many of those same employees and Board members, a lack of internal controls that allowed the spending of $90 million in one year without any capital budgeting and evaluation process, and questionable fiduciary responsibility of owner-member funds. Also discovered were the Andersen/Enron-style destruction of co-op files and creative accounting methods (in this case, entries that increased membership equity through the addition of the value assigned to underground power systems built by residential developers). The compensation and perks for Board members and executives were seen as excessive, and owner-members became enraged at the fact that they hadn't received any capital credits and that co-op charge rates weren't lower than those of publicly owned electricity companies. Management pointed out that the excess of revenues over expenses was going to fund capital assets and "product development" (such as SSS's software design). As such, management claimed, there really wasn't any cash available to provide owner-members with their hoped-for dividends.

Required:

1. What items should have raised "red flags" to Marcos as he performed his job duties?

2. Given IMA's *Statement of Ethical Professional Practice*, how might Marcos assist the consulting firm in its investigation?

3. Assuming full knowledge of the financial circumstances of MEOU's operations, what actions *could* Marcos have taken *prior* to TransparenSee's involvement through the owner-members' lawsuit?

4. Assuming full knowledge of the financial circumstances of MEOU's operations, what actions *should* Marcos have taken *prior* to TransparenSee's involvement through the owner-members' lawsuit?

5. What consequences (to Marcos and others) might have occurred based on the actions discussed in questions 3 and 4? **SF**

Teaching notes are available by contacting Jodi Ryan, manager of Student and Academic Relations, at jryan@imanet.org.

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1 Better Government Association and National Freedom of Information Coalition, *Results and Criteria of BGA/NFOIC Survey*, 2007, www.bettergov.org/pdfs/foia_results_2008.pdf.