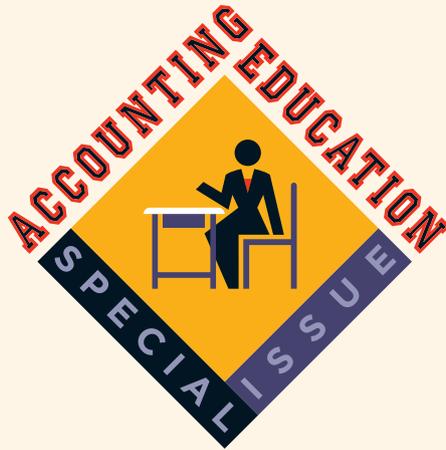


The Student Case Competition is sponsored annually by IMA® to provide an opportunity for students to interpret, analyze, evaluate, synthesize, and communicate a solution to a management accounting problem.



OUT OF CONTROL:

Lax Procedures at National Capital Trust?

By Ron Messer, CA, CMA (Canada)

As manager of the Finance department for National Capital Trust, Miriam Richardson was in charge of financial functions at the institution. It was her job to ensure that clients' funds were managed properly. In August 2013, Miriam noticed several unexplained changes in various accounts, including some accounts that were worth millions of dollars. Small sums of money were being withdrawn frequently, and large undocumented credit card purchases were being made. The Legal Services department also reported that an unusually large number of amendments were being made to client wills. With all this going on, Miriam was concerned about the safety of the customers' assets.

Background

National Capital Trust (NCT) was formed in the 1970s to provide trustee services for elderly clients. Even as it grew and subsequently offered additional services to its customers, NCT remained first and foremost a trust company. As its aging client base grew, more assets were being

placed in the hands of NCT's professional staff. As a trustee, the company provided security for money held in its accounts, items in safety deposit boxes (such as jewelry), investment portfolios, and real estate assets. To do this, NCT was assigned power of attorney (POA) over the client's assets through a document completed by the client or a family member. Clients' bills were paid with funds held in the trust, and their assets were managed so that they could maintain a comfortable lifestyle.

Miriam was concerned that financial safeguards had not kept pace with the rapid growth in NCT's assets. Fraud was always a possibility when dealing with assets held in trust. In fact, the company's external auditors and regulatory authorities had identified weaknesses in the internal controls on several occasions. Unfortunately, very few of these issues were addressed. As one senior manager said, "We trust our employees." In addition, Miriam's department was constantly backlogged with work, and the shortage of workers with the necessary skills made it difficult to find qualified candidates to hire.

Business Process

NCT has four client-facing departments: Client Services, Finance, Investments, and Legal Services (see Figure 1). The processes at the company relating to trust accounts involve client enrollment, administration procedures, and transaction controls. Figure 2 provides an overview of the processes relating to client accounts, while Figures 3 and 4 contain a sample of job descriptions and NCT policies and procedures.

Client Enrollment

For an individual to enroll with NCT, an application form needs to be completed in the Client Services department. This typically is done by a family member of the elderly customer. The customer's assets are catalogued by a representative of NCT who goes to the individual's home to take an inventory of valuables. In the past, two individuals usually went and catalogued everything, but staff shortages resulted in only one bank representative now being sent. Assets that get catalogued could include jewelry, collectibles, and—not uncommonly—loose cash. The assets are then placed in a secure location at NCT (or sometimes offsite), and a POA is assigned to the trustee to make prudent financial decisions on the client's behalf. Assets are held in trust until the client dies. At that time, they are distributed based on the terms of the will. The Legal Services department coordinates client POA documents and wills.

Administration Procedures

NCT assigns a case worker from its Client Services department to each new customer. It's the case worker's job to contact clients periodically to ensure their well-being. For example, if the individual is in a care facility, the case worker ensures the person is properly fed, clothed, and bathed.

A financial representative in the Finance department works with the case worker to ensure that all financial issues, such as paying bills and making small purchases (e.g., a television for personal use), are handled properly. It's the job of the financial representative to ensure the propriety of any payments made, including providing appropriate supporting documentation for any disbursements. In most cases, family members aren't interested in caring for their elderly parents. As a result, the case worker becomes the main personal contact for many clients, and close ties frequently develop between client and case worker.

Transaction Controls

Prior to a payment being made, a pre-audit is done on the disbursement to ensure that (1) it relates to the correct client, (2) the funds are taken from the right account, (3) the necessary approvals have been obtained, and (4) appropriate supporting documentation is provided. Payments can be made by way of petty cash, check, or by using a client's credit card. Payments are authorized by the case worker and approved by the financial representative. The Finance department requires supporting documentation for the disbursement, but it isn't always provided. Case workers can make small payments using petty cash, which is taken directly from the client's bank account. Because of the small dollar value of these disbursements, supporting documentation usually isn't provided to the financial representative who approves the transactions.

The Finance department receives cash from client investments (such as dividend checks, interest on bonds, and certificates of deposit, as well as rent from real estate holdings). Incoming mail is opened by the client's financial representative. Any cash or checks received are deposited into the appropriate account by the financial representative and recorded by both the Investments department and the Finance department. NCT's auditors had noted that a bank reconciliation of the cash received and cash deposited was required but not always completed on a timely basis.

New Hire

A new case worker was hired in January 2013 to alleviate staff shortages and deal with the large backlog of work, particularly in client enrollment. She seemed to be the ideal candidate. She had relevant work experience, proper academic qualifications, and had performed well on aptitude tests. In addition, phone calls placed to her references resulted in glowing reports.

NCT's Human Resources (HR) department was tasked with verifying the candidate's credentials. Unknown to the HR person checking her qualifications, the person who provided confirmation of the candidate's prior work experience also served as a reference and was a close personal friend of the applicant. Also unknown by HR was the fact that her qualifications came from an obscure college located outside the country. A photocopy of her degree had been accepted as evidence of education. These vetting procedures weren't normal practice for HR, but the department was short-staffed and busy trying to fill numerous positions. The urgency to fill the case worker

Figure 1: National Capital Trust Organization Structure

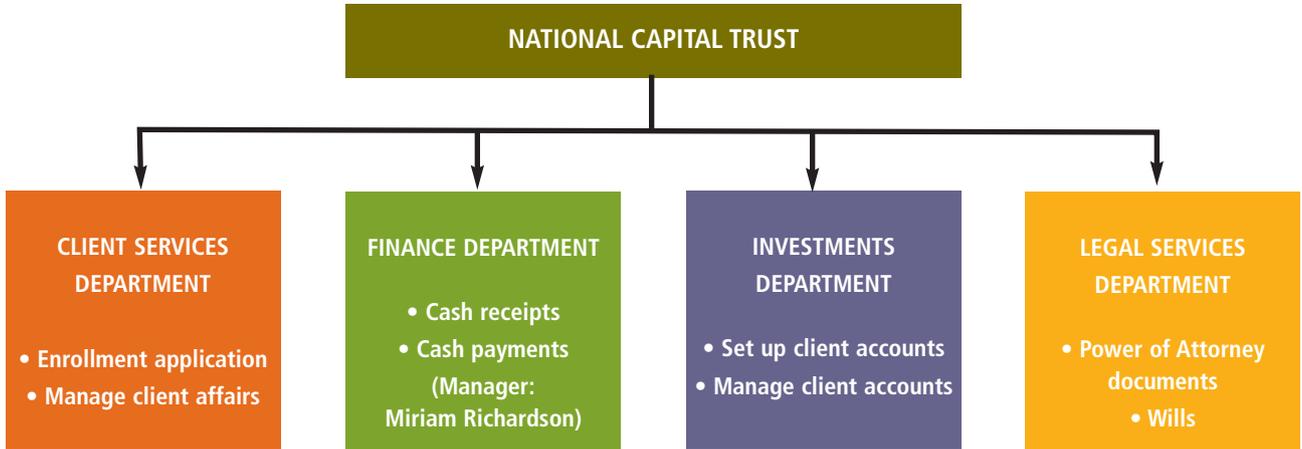


Figure 2: Processes for Client Accounts

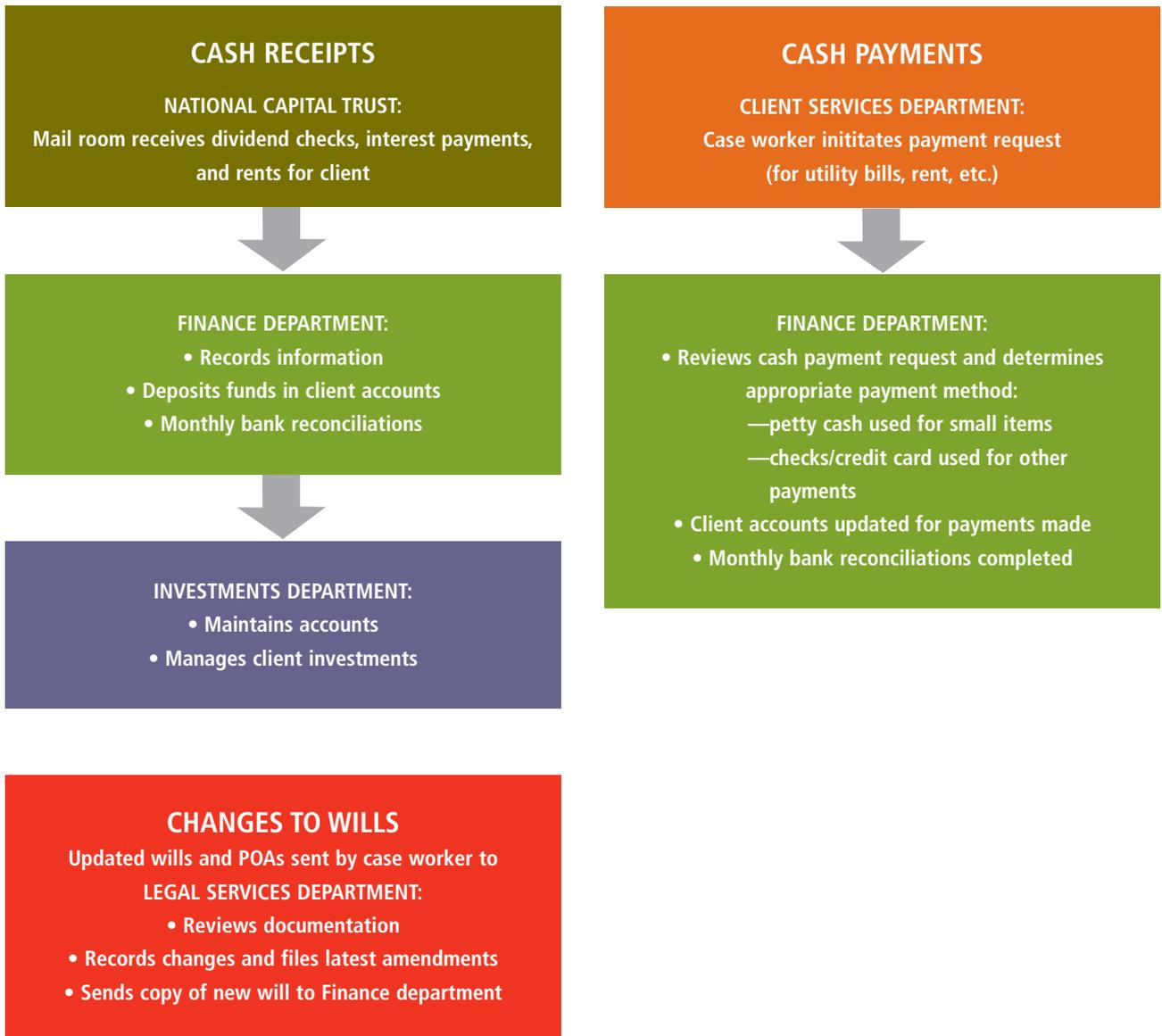


Figure 3: Manager Job Descriptions (excerpts)

Manager of Client Services

Key responsibilities include:

- ◆ Processing intake forms for new clients
- ◆ Custody, recording, and safeguarding of client assets (jewelry, collectibles, etc.)
- ◆ Coordination of case workers and clients
- ◆ Hiring/training of new case workers

Manager of Finance

Key responsibilities include:

- ◆ Security over cash receipts and payments made on behalf of clients
- ◆ Pre-audit of client payments before disbursement
- ◆ Maintaining accurate and complete client financial records and bank accounts
- ◆ Managing client petty cash funds

Manager of Investments

Key responsibilities include:

- ◆ Safeguarding client investments (securities, real estate, etc.)
- ◆ Ensuring appropriate returns on client assets, in compliance with investment policies
- ◆ Preparing quarterly client investment statements
- ◆ Liaising with the Finance department

Manager of Legal Services

Key responsibilities include:

- ◆ Representing clients in court proceedings (e.g., will variation disputes)
- ◆ Processing files and maintaining security over all legal documents
- ◆ Managing/reviewing client POAs and wills and ensuring they are current and authorized
- ◆ Acting as executor for deceased clients

Figure 4: NCT Policies and Procedures (excerpts)

Petty Cash

Petty cash funds are to be used for purchases costing \$50 or less, chargeable to a client account. All such purchases must be supported by a paid invoice or a receipt. A petty cash fund is an imprest fund. This means that the fund is always at the same value. At all times, the cash on hand, plus vouchers or invoices representing amounts paid from petty cash, plus the amounts awaiting reimbursement, must equal the value of the fund. The petty cash fund is subject to audit on a periodic basis.

Payments on Behalf of Client

Receipts provide documentation for purchases made by check or credit card. The overriding expectation is that receipts or paid invoices are to be submitted as documentation for these purchases.

Receipt and Safeguarding of Cash

The mail room will forward all client correspondence to the Finance department, where the financial representative responsible for a client will open the mail. Cash received must not be left unattended during the day. Funds should be stored overnight (or during the day when unattended) in a cashbox within a locked cabinet or safe to which there is restricted access. Ideally, one person should be held responsible for the safekeeping of funds. Deposits of funds are to be done daily.

Client Bank Accounts

Bank reconciliations should be completed on a timely basis (monthly) for all client accounts and should be reviewed and approved by a supervisor.

Signing Authorities

All client funds must be administered through the client bank account(s) maintained by the Finance department. The following persons are authorized to sign all checks on all bank accounts for their clients: (1) financial representative or (2) case worker.

Security of Credit Card Information

National Capital Trust is bound by contract and by law to keep confidential any credit card information received from clients or any other party. All copies of credit card receipts should be sent with cash transmittals or tallies to the Finance department, which then stores these documents in a secure location until the documents can be destroyed.

Figure 5: NCT Corporate Governance (excerpts)

The Board of Directors will be composed of 12 members. Four committees will be formed from these members:

Compensation Committee (4 members)

This committee makes recommendations on the amount of remuneration paid to the CEO and senior executives, including base salaries, bonuses, and other compensation.

Audit and Risk Management Committee (4 members)

The audit and risk management committee will be responsible for approving the company's financial statements and liaising with the external auditors. The committee is responsible for developing and implementing an appropriate risk management strategy, including ensuring good internal control practices, which should encompass, but is not limited to, the following:

- ◆ Proper segregation of duties
- ◆ Maintaining complete and accurate client records along with supporting documentation
- ◆ Safeguarding client and company assets
- ◆ Proper and timely authorization of transactions and reconciliation of accounts
- ◆ Creating an internal audit function (Note: To date, this has not been done by the committee)

Audit committee members must be independent in their dealings with NCT. This includes any relationship for which they could receive a financial gain. At least one of the members of the committee must be financially literate.

Capital Projects Committee (4 members)

The committee is tasked with the review and approval of all major capital projects, including expansion and refurbishment of NCT facilities.

Strategy Committee (4 members)

The committee is tasked with developing and implementing corporate strategy on an annual and long-term basis.

position and time constraints led to the relaxed standards.

Assignment

In August 2013, Miriam noticed that some of the client accounts were becoming seriously depleted without any apparent reason. In addition, clients' petty cash accounts were being used more often than usual. The Legal Services department notified Miriam of changes to clients' wills that, while not unusual, weren't frequent occurrences. Miriam wanted to investigate these apparent anomalies and make the necessary changes.

Your assignment is to address each of the following questions:

1. In general, what are the major objectives of internal control? What is their purpose?
2. What are the risks associated with providing financial services such as those of a trustee? Classify each risk as (1) high, (2) medium, or (3) low.
3. Review the processes outlined in the case and indicate where:
 - a. Controls *should be* in place but do not exist, and
 - b. Controls are in place but aren't working effectively.
4. For each of the controls that are in place, or should be, identify whether that control is preventive or detective.
5. Was NCT's senior management adequately performing its *fiduciary* responsibilities on behalf of its clients (see Figure 5)? Give an example of how it was, or was not, meeting its responsibilities.
6. What are the *ethical* responsibilities of senior management toward its clients?
7. How would you test whether inappropriate activity (potential fraud) had occurred?

Real-Life Results

In this real-life business situation, fraud was uncovered after Miriam's suspicions caused her to approach senior management with her concerns. The company spent more than \$1 million to assess the extent of the fraud. Although the financial institution desperately wanted to avoid any negative publicity, news of the incident was reported and caused significant embarrassment. All misappropriated funds were eventually recovered, and the perpetrator was sent to jail for several years. **SF**

Ron Messer, CA, CMA (Canada), is a faculty member in the School of Business at Kwantlen Polytechnic University in Vancouver, Canada. You can contact Ron at (604) 733-9783 or ron.messer@kwantlen.ca.