

Midwest National Bank: A CASE STUDY

Tina Quinn, Arkansas State University (email: tquinn@astate.edu)

Dwayne Powell, Arkansas State University (email: dpowell@astate.edu)

Rodney F. Carmack, Arkansas State University (email: rcarmack@astate.edu)

Abstract—

Mrs. Overbay had worked her way up the ladder at MNB and now held the position of branch manager at the downtown branch. Because Mrs. Overbay had been an excellent employee and had built up a loyal customer base, she was allowed to continue handling deposit transactions in addition to loan officer duties even after being promoted to branch manager. But the future did not look bright for Mrs. Overbay. Medical problems had forced her husband to dissolve his successful law practice, leaving Mrs. Overbay as the principal bread winner. Medical expenses soon exceeded insurance benefits. The Overbays had exhausted their savings, their financial status was deteriorating and Mrs. Overbay was quite distraught. One day she accidentally deposited a customer's check into her personal checking account (it was an honest mistake). The next day she was examining her account balance and realized her mistake. If she corrected the mistake, she would be overdrawn and lose her job. So she credited the customer's account and debited a 'suspense' account. When no one noticed the entry (she was in charge of reconciling the 'suspense' account), she continued the practice. However, one day Mrs. Overbay stayed home with her husband and one of the loan assistants decided to be helpful and reconcile the account for Mrs. Overbay. When the discrepancies came to light, the assistant called internal audit which discovered her actions.

I. INTRODUCTION

The three legs of the fraud triangle (pressure, opportunity, rationalization) are all present in this case. Mrs. Overbay was under both emotional and financial pressure. The opportunity for fraud presented itself in the form of an honest mistake. If she corrected her mistake, she would be in danger of losing her job, thus giving her justification for her actions. The purpose of this case is to help students develop an understanding of internal controls and accounting systems through a practical "real world" situation. The appropriate audience is upper level undergraduate accounting students in Auditing, Fraud Examination or Accounting Information Systems. Through discussion of the case, students can be expected to learn to identify

internal control and system weaknesses. In addition, they should learn to develop recommendations to correct weaknesses in systems of internal control.

Midwest National Bank (MNB) is a small regional bank headquartered in Overland Park, Kansas. It has 216 branches located throughout the Midwest. Jane Overbay is the branch manager in the Topeka - Downtown Branch. This location is a full service branch with high transaction volume. It has approximately \$300 million of deposits and approximately \$250 million of loans. The Topeka - Downtown Branch has five full-time tellers and seven part-time tellers, two loan officers and three loan assistants in addition to Mrs. Overbay. Mrs. Overbay started working for MNB as a part-time teller while attending college to obtain a degree in psychology. Once she graduated from college she was unable to find a job directly related to her degree so she continued working for MNB as a full-time teller.

Mrs. Overbay developed a following of loyal customers by providing superior customer service. Many customers would only allow Mrs. Overbay to handle their transactions. Management of MNB recognized Mrs. Overbay's dedication, as well as her commitment to MNB and its customers. As a result, MNB promoted Mrs. Overbay to loan officer. Management did not want to upset Mrs. Overbay's loyal deposit customers so they allowed her to continue handling deposit transactions.

Mrs. Overbay was also an excellent loan officer and over the next several years built a significant portfolio of loans. As a result of Mrs. Overbay's superior client service skills, many of her customers would only work with Mrs. Overbay. Fifteen years after Mrs. Overbay graduated from college, the branch manager of the Downtown branch retired and Mrs. Overbay was promoted to branch

manager. MNB acknowledged that there were many loan and deposit customers that demanded that Mrs. Overbay handle their business. Not wanting to upset Mrs. Overbay's customers, management decided Mrs. Overbay should continue serving her loan and deposit customers in addition to being responsible for management of the Topeka - Downtown Branch.

MNB management encouraged Mrs. Overbay to attempt to transition many of her customers to other employees. However, when customers asked for Mrs. Overbay, she continued to accept deposits, cash checks, approve overdrafts for the Topeka - Downtown Branch customers, accept loan payments, post loan payments and originate new loans. Origination of loans included the disbursement of loan proceeds. Mrs. Overbay was granted the authority to approve loans up to \$100,000. Mrs. Overbay continually received "5-Star" evaluations (the highest possible) from customers on the quarterly customer service surveys performed by MNB. She also received excellent reviews and comments from the employees that worked with her and from her supervisors.

Two weeks after Mrs. Overbay's 42nd birthday, her husband, a successful local attorney, was diagnosed with Lou Gehrig's disease. While MNB provided great health benefits that covered most of the medical expenses, it was not long before the disease progressed to a point that Mr. Overbay was no longer able to work and it was necessary to dissolve his law practice. Without Mr. Overbay's income, it became increasingly difficult for the Overbays to cover their expenses, even though they lived a relatively frugal life and had significant savings prior to Mr. Overbay's illness.

One afternoon after receiving a particularly grim prognosis of her husband's future, Mrs. Overbay was in her office looking at the lack of funds in her checking account when in walked one of her long-time deposit customers and friend, Bill Freeman. Bill had known the Overbays for many years and was aware of Mr. Overbay's medical condition. He could tell by Mrs. Overbay's demeanor that she was upset. Before he asked her to deposit a check, he asked about Mr. Overbay. They spent several

minutes discussing Mr. Overbay's condition and the doctors' prognosis.

Eventually, he handed Mrs. Overbay the check he wanted to deposit. She deposited the check into the account open on her computer (She was not focused on the business transaction and forgot that she had not opened Mr. Freeman's account. (It was an honest mistake.) Mr. Freeman was a frequent customer of Mrs. Overbay's and having complete trust in her he did not take his receipt. When Mr. Freeman left the office, Mrs. Overbay was behind and began rushing to wrap up the day's activities.

The next morning the first thing Mrs. Overbay did after getting a cup of coffee was look at her checking account. She immediately realized that she had deposited Mr. Freeman's check into her checking account. She also realized that if she corrected the mistake, she would be significantly overdrawn with no means of covering the overdraft until payday. Two large checks had cleared her account the previous evening. One check was to Topeka Memorial Hospital and the other was to We Care Medical Supply. MNB had a strict no overdraft policy for employees. The employee handbook stated that if an employee's account was overdrawn, the employee could be terminated immediately. If she did not correct the error, Mr. Freeman would notice the error when he received his monthly bank statement. The error would be difficult to explain.

Mrs. Overbay decided not to take the money out of her account. Instead, she credited Mr. Freeman's account for the amount of the deposit and debited a suspense account for an equal amount. Banks frequently use suspense accounts to hold items until the correct account can be determined. Each item should clear out of the suspense account within 24 - 48 hours. Occasionally, an item will stay in the suspense account slightly longer. The bank should maintain a detailed list of all items in the suspense account. The suspense account should be reconciled to the detailed list daily. As branch manager, Mrs. Overbay was responsible for reconciling the suspense account for the Topeka - Downtown Branch.

Mr. Freeman's deposit remained in the suspense account for several days and no one detected the problem. A couple of weeks later, the Overbay's account was running low again and was at risk of being overdrawn. Mrs. Overbay deposited two payment checks from loan customers' into her checking account. To prevent the customers from receiving a late notice, she credited their loan and debited the suspense account. The fraudulent transactions were not detected. Over the next 17 months, Mrs. Overbay continued this practice. When her checking account was in danger of being overdrawn, she would deposit a customer's check into her account.

As Mr. Overbay's death became imminent, Mrs. Overbay spent more time at home to care for her husband and deal with the many issues related to his failing health. As a result, one of the loan assistants (in an effort to help Mrs. Overbay) attempted to reconcile the suspense account. She immediately realized that something was not correct. She assumed that since Mr. Overbay had been sick, Mrs. Overbay had not had an opportunity to reconcile the account and called internal audit in the home office for assistance.

As internal audit began tracking the transactions, it became obvious that Mrs. Overbay had been stealing customer funds. They completed their audit the day Mr. Overbay passed away. Mrs. Overbay stole \$576,271. Most of the stolen funds were used to pay for care for Mr. Overbay.

A. Requirements:

Identify and discuss the internal control deficiencies that allowed Mrs. Overbay to perpetrate her fraud.

Identify preventive, detective and corrective controls that should have been in place at MNB.

Discuss the Fraud Triangle. How do the concepts of the Fraud Triangle apply to this case?

Assume you are the CEO of MNB. How would you handle this case? Are there any ethical issues that should you should consider? If so, discuss the issues.

II. TEACHING NOTES

A. Summary

Mrs. Overbay had worked her way up the ladder at MNB and now held the position of branch manager at the downtown branch. Mrs. Overbay had been an excellent employee and had built up a loyal customer base. Due to this customer base, she was allowed to continue handling deposit transactions in addition to loan officer duties even after being promoted to branch manager. She also had the authority to approve loans up to \$100,000.

Soon after her husband was diagnosed with Lou Gehrig's disease, he dissolved his successful law practice, leaving Mrs. Overbay as the principal bread winner. Although the bank provided medical insurance, the medical expenses exceeded the insurance benefits. The Overbay's had exhausted their savings and their financial status was deteriorating.

The future looked grim and she was quite distraught and accidentally deposited a customer's check into her personal checking account (it was an honest mistake). The next day she was examining her account balance and realized her mistake. If she corrected the mistake, she would be overdrawn and lose her job. So she credited the customer's account and debited a 'suspense' account. When no one noticed the entry (she was in charge of reconciling the 'suspense' account), she continued the practice.

However, one day Mrs. Overbay stayed home with her husband and one of the loan assistants decided to be helpful and reconcile the account for Mrs. Overbay. When the discrepancies came to light, the assistant called in internal audit and discovered her actions.

B. Teaching Objectives and Target Audience

Teaching objectives: The student should be able to:

- Identify weaknesses in internal controls.
- Understand how such weaknesses could lead to theft.
- Discuss measures to prevent and detect cash larceny.
- Understand and identify methods used by fraudsters to conceal cash larceny.

- Apply the fraud triangle.

This case could be used in an auditing class and/or a fraud examination class.

Questions for an auditing class:

- Identify and discuss the internal control deficiencies that allowed Mrs. Overbay to perpetrate her fraud.
- Identify preventive, detective and corrective controls that should have been in place at MNB.

Questions for a Fraud Examination class:

- Identify and discuss the internal control deficiencies that allowed Mrs. Overbay to perpetrate her fraud.
- Identify preventive, detective and corrective controls that should have been in place at MNB.
- Discuss the fraud triangle.
- How do the concepts of the Fraud Triangle apply to this case?

Questions for auditing or fraud examination class:

- Assume you are the CEO of MNB. How would you handle this case?
- Are there any ethical issues that should be considered? If so, discuss the issues.

C. Analysis

Identify and discuss the internal control deficiencies that allowed Mrs. Overbay to perpetrate her fraud.

The internal control deficiencies that allowed Mrs. Overbay to perpetrate her fraud included:

- Lack of segregation of duties and responsibilities.
- Lack of appropriate system of internal control.
- Inadequate frequency of audits.
- Lack of appropriate supervision.
- Lack of multiple levels necessary to authorize transactions.

Identify preventive, detective and corrective controls that should have been in place at MNB.

- Appropriate segregation of duties should apply to bank general ledger account reconciliations.
- Computer user access should be limited to specific roles and responsibilities.
- Increase multiple layers of authority.
- There should be secondary approval of transactions.
- Video surveillance cameras should be in place.
- There should be appropriate rotation of duties.
- There should be a mandatory vacation policy.
- The internal audit function should be expanded and enhanced.
- There should be an audit committee.

Discuss the fraud triangle.

Cressey's fraud triangle is based upon three factors that contribute to fraudulent activity. The three legs of the triangle are a perceived non-shareable financial need, perceived opportunity and rationalization.

- Pressure is generally present when the perpetrator feels they have an unshareable problem. In this case, Mrs. Overbay's husband was ill and the medical bills were piling up. The bank's policy was to terminate any employee whose account was overdrawn.
- Mrs. Overbay had the opportunity to perpetrate the fraud as she was given too much authority over too many transactions. When she accidentally deposited a customer's check into her personal account, she decided to credit the customer's account and debit a suspense account. She was responsible for reconciling the suspense account. When weeks passed and no one detected the problem, she continued to deposit customers' check into her personal account.
- Rationalization actually occurs before a fraud takes place. When she realized that she had accidentally deposited a customer's check into her personal account, she also realized that she would be overdrawn if she corrected her error. That would lead to her termination at

a time when her husband was seriously ill and needed medical treatment.

Assume that you are the CEO of MNB. How would you handle this case? Are there any ethical issues that should be considered? If so, discuss the issues.

MNB has few options:

- Fire Mrs. Overbay.
- Demand repayment for the stolen funds along with any fees incurred.
- Try to keep publicity at a minimum.
- Federal law would require the Bank to notify authorities (Police/Prosecutor) who would determine whether or not to press charges. The bank would also be required to file a Suspicious Activity Report (SAR) with FinCEN (a branch of the Treasury Department). Few students would have this knowledge.

Ethical issues:

- Although the bank provided medical insurance to its employees, was the coverage sufficient? If the medical insurance was sufficient, why did Overbay accumulate so much debt? Perhaps the bank should review its benefits package.
- It appears that Mrs. Overbay's superiors were unknowingly complicit in the fraud by allowing her to wear many different hats and giving her too much authority.