Book of Accounting Blunders

Attention to detail is a maxim worth repeating especially when it comes to managing your finances. Everybody makes mistakes, even the big boys, and this collection of accounting blunders shows how important it is to keep on top of the numbers.

Contents

Keeping accounts, simply

We all laugh at the misfortunes of others - a bit naughty, perhaps, but there are lessons to be learned from the mistakes of others. After all, that is often how Best Practice has evolved.

No one, and no one organisation, can hope to be perfect. What we must strive to do is avoid the common pitfalls and take enough care to minimise the less obvious ones - that is what good financial and accounting software is for: to keep the books accurately and consistently in compliance with the laws of the land and the Revenue.

Everybody makes mistakes - but if the big guys can make mistakes, what hope is there for the rest of us? Well, this Big Red Cloud Book of Accounting Blunders is aimed at addressing just that – I hope it will make you smile, but I also hope it will make you think and appreciate how important it is to keep on top of the numbers.

The Big Red Group has been supporting smaller enterprises since 1993; our focus is set firmly on keeping accounts simple and easy to use.

We offer our proven software both as a traditional on-premise PC application, and as an online Software as a Service (SaaS) subscription service through Big Red Cloud.

We see our role as helping smart modern enterprises make better business decisions and setting the foundations for future growth. Right now there are over 35,000 Big Red Book user companies in the UK and Ireland - our aim is to **keep it simple, but smart**.

Marc O'Dwyer
CEO

Blunder 1

Discounting the cost of refunds

Background

Groupon.com was one of the first online discount websites, offering money off a wide range of goods while offering services and very attractive Deal of the Day promotions. Today it has operations in over 160 national markets, including the UK (www.groupon.co.uk), and boasts an estimated 35 million registered users.

Groupon went public in late 2011, raising an astounding US$11 billion. But the rapid growth pains showed very quickly and the following March it had to add $14.3 million to an already declared loss of $37 million for the previous quarter.

What went wrong?

Auditors Ernst & Young found a basic accounting blunder, described delicately as “a material weakness in internal controls.”

> Groupon had made an inadequate allowance for the inevitable refunds to customers

In essence, Groupon had made an inadequate allowance for the inevitable refunds to customers across a huge volume of transactions. Another element of the problem was that it was having trouble collecting refund reimbursements from its merchant partners.

Groupon acknowledged to The Wall Street Journal that it lacked 'adequate policies and procedures' to assess its financial assumptions.

Lessons learned

Groupon survived, with its reputation intact and with thousands of British users happy with their deals. But a smaller business or one less enthusiastically received by the market could easily have gone out of business.

Allowing for lost or damaged goods, returns under warranty or any other reversal of the gross value of a sale is basic when you are selling goods. Even small retailers have to allow for some 'shrinkage'. Remember total sales are the maximum. Everything comes off that.

As for chasing payment, you need a good collection system because that's your working capital out there, sitting in someone else's bank account. Until you collect, you cannot make a profit.

Blunder 2

Charging the wrong fare

Background

The iconic London taxi has been manufactured in Coventry since 1948, originally designed as the Austin FX3. Since the early 2000s they were made by the **London Taxi Company**, a subsidiary of Manganese Bronze Holdings plc, who in turn were 20% owned by Chinese car maker Geely. London's black cabs played a central part in the closing ceremony of the 2012 Olympics.

What went wrong?

Shortly after the Olympics the company's shares took a 34% dive in just one morning, as a £3.9 million accounting blunder was revealed. According to the auditors, the cumulative effect of 'systems and procedural errors' in the previous two years had led to an understatement of historical losses.

> Two years of 'systems and procedural errors' led to an understatement of historical losses

Blame was laid on the transition to a new integrated software solution designed to help manage the company's global supply chain and transfer ledger balances from the previous system. The company and its auditors referred to ensuing errors that led to the overstatement of stock and understatement of liabilities in the financial statements of previous years.

The company went into administration a few months later, shedding more than half of its nearly 300 strong workforce. After some months of negotiation it was bought by its minority shareholder Geely. Today's London cabs are still made in Coventry.

Lessons learned

What really went wrong? It certainly seems to have been an all too familiar chain of events where an initial error or omission is compounded by repetition and time.

Perhaps the core warning is that a major system's change always carries a risk of error. The answer is to ensure that your system remains capable as you grow, and to check everything again and again.

Blunder 3

Dressing up the value of stock

Background

The highly successful online fashion label **Superdry,** sold in 54 countries, is a brand of the SuperGroup plc retail group, quoted on the London Stock Exchange and one of the FTSE 250 companies. The group has 105 standalone stores in the UK and Europe (Cult, Superdry) and 270 franchises or concessions. In early 2012 its share value took a 38% tumble.

What went wrong?

The group had issued a profit warning which included the announcement of a £2.5 million accounting error discovered in a routine audit. The result was a shortfall of that amount in the profits from its wholesale business. In all, over £170 million was wiped off the company's total share value.

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The most startling aspect was that the primary cause was described by the finance director as 'arithmetic errors'. That turned out to be pretty basic - a 'plus' instead of a 'minus' in the company accounts. It happened at a senior level in calculating the value of stock that was moving around the business. Adding £1.25 million instead of taking it away resulted in a £2.5 million gap.

As most business owners are aware, problems rarely surface individually. The company also misjudged its forecasts in the same wholesale division as well as in its retailing activity. So two further adjustments of £2 million had to be made and the end result was that its pre-tax profit forecast was out by over £6.5 million.

Lessons learned

The verdict of the expert analysts in the sector was that the company had clearly outgrown its internal control systems. So make sure that the system is scalable and does not inhibit future growth.

Blunder 4

Defending the cost of double accounting

Background

When Canadian federal auditors found accounting errors amounting to an estimated $1.5 billion in a routine study of the Canadian Defence Department's books, the official description was dryly understated and labelled as 'significant'. Hard to disagree!

Canada's National Defence accounts for 7% of the federal budget. As a direct political result of the auditor's report its budget was slashed by $2.1 billion.

What went wrong?

The Auditor General's team found that the same ship-borne anti-missile system had been counted twice ($210 million), the price of torpedoes was misstated ($15 million) and somebody forgot to remove two CF-18 fighter jets from inventory a year after they had crashed in well publicised training accidents.

> The same ship-borne anti-missile system had been counted twice

Similar failures to record changes in inventory occurred in regard to a retired Chinook helicopter fleet valued at $81 million and $36 million worth of vehicles held for disposal at a Montreal depot. A sum of $200 million was incorrectly recorded for services that had not yet been supplied.

The Defence Department has taken action to address some of the problems, notably by investing in a new inventory system so that officials do not count equipment assets twice.

Lessons learned

Is there a lesson here for small firms and stock control? It is a reminder that miscounting, in business as in defence, can give rise to a false sense of security and influence bad decision-making.

Blunder 5

Wiping out the wrong data

Background

ICT equipment distributor **Tech Data** is a 40-year old US-headquartered giant and NASDAQ listed corporation with annual sales of over US$25 billion. So a $27 million (£16.55 million) set of accounting errors in its UK subsidiary was a major embarrassment. Forensic accountants were called in and the net result was the wiping of that $27 million off the corporation's profits for the last three years.

What went wrong?

An Audit Committee of independent investigators and lawyers found systemic accounting failures in the UK and two other European countries. Their findings included '…errors from improper vendor accounting, improper use of manual journal entries and improper recognition of foreign currency exchange transactions.'

That word 'improper' is also highlighted by the dismissal of certain staff in the UK and elsewhere who were "responsible for accounting improprieties." Some other clues to events might be inferred from the company's decision to change its compensation programmes '…to better motivate accurate financial reporting and compliance.'

$27 million was wiped of off the corporation's profits for the last three years

Yet more insight comes from the letter sent to all staff members reminding them of ethical matters and "the imperative to comply with laws, Code of Conduct and company accounting policies." Tech Data UK has announced the appointment of "external experts to perform the internal audit function and to assist with the implementation of specific fraud detection procedures."

Lessons learned

When administering sales commissions and bonuses, management have always to consider what exactly is being incentivised. Sales in, verified and paid for, seems a good if slightly old fashioned rule.

Blunder 6

Writing off goodwill

Background

When **Blackpool Council** was forced to write off more than £31,000 in debt it was slammed publicly by both trade unions and its own councillors. "We are a council forever saying we are strapped for cash and can't do this and that…but we could have kept a staff member employed for a year with this money" one irate councillor told the Blackpool Gazette.

What went wrong?

The problem began when the council sold off some items that had been discarded at its municipal recycling centre for household waste. There was residual value in the goods deposited at the centre by the good citizens of Blackpool. These goods included home electrical equipment such as kettles, toasters and vacuum cleaners as well as textiles and bric-a-brac.

> Apparently there was some residual value left in the goods

The goods were sold by the council to a reclamation business between August and December 2012 for a total of £31,342 but the council never actually invoiced the reclamation business for the goods. Shortly after in Feb 2013, the company which had bought the goods went into liquidation. As no invoices were ever issued by the Council they had no claim to the money at all.

The furious reaction was probably predictable since Blackpool Council was proposing to axe around 700 jobs over the next two years as part of plans to save £36 million.

Lessons learned

Everyone in a small business understands that a sale is not a sale until it has been invoiced. Then you pursue the debtor because they have your money - that is key to preserving jobs.

Blunder 7

Storing up a problem

Background

With over a century in business and a NASDAQ listing, Diamond Foods is a giant in the US snack food industry, specialising in potato and nut based products amongst other things. Started in 1912 in California as the Diamond Walnut Growers cooperative its sales now total over US$1 billion in 100 countries - products include Kettle Chips.

Diamond's ambition to acquire one of their competitors, Pringles, led to auditors identifying major accounting blunders in Diamond's books, which in turn scuppered its $2.35 billion bid to buy Pringles. Subsequently Pringles was duly acquired by arch rival Kellogg's.

The accounting errors story broke in 2012 and forced Diamond to re-state its earnings for 2010 and 2011. This led to a settlement of $96.1 million in a class action by investors, a $5 million fine by the Securities and Exchange Commission and a personal penalty of $125,000 for then CEO Michael J. Mendes.

What went wrong?

Diamond had manipulated its payments to nut growers to artificially inflate its gross profits. That pushed the share price upwards which gave it the market leverage to go for Pringles. The walnut growers, who were traditionally paid at intervals throughout the year, were underpaid in a given year and the difference made up the following year as somewhat creatively described 'continuity' and 'momentum' payments. Constantly pushing its true costs forward enabled Diamond to beat market forecasts every quarter. Since the loyal if confused walnut farmers did all get paid in the end, the breaches of accounting principles became the only illumination in the moral murk. Stock market investors, on the other hand, were clearly misled as the $96 million settlement confirms.

Lessons learned

Most small business managers will find their heads spinning.

In their very real world, a purchase is on the debit side when the goods are received, a sale is credited when goods or services are delivered. Credit terms, cash flow and a hard look at the P/L figures cover everything else.

Getting too creative is always a recipe for disaster.

Blunder 8

Spreading the pain

Background

The 125-year old Woking-based business services group Mouchel is a major provider of outsourced infrastructure and services to national and municipal authorities. Its name remembers its founder Louis Gustave Mouchel, who in 1897 first brought ferro-cement to British civil engineering projects.

> A simple spreadsheet error became the proverbial straw that broke the camel's back

A £4.3 million accounting error led to a surprise profit warning in 2011, the immediate resignation of its CEO, tough reviews by its bankers and de-listing from the Stock Exchange the following year. Already under pressure from public sector cutbacks in 2011, Mouchel had negotiated an exit from several long term contracts and was re-structuring its heavily geared loan finances. The error and share price plunge triggered further reviews by its bankers.

Yet the immediate cause of the problem was not the fault of senior management.

What went wrong?

The problem was caused by a spreadsheet error made by an external firm of consultant actuaries. The error resulted in a wrongly valued pension fund deficit and a direct hit on the company bottom line.

Lessons learned

So a simple spreadsheet error became the proverbial straw that broke the camel's back. Mistakes in business and accounting can often have unforeseen consequences; so additional care and attention and robust internal controls are an essential part of good accounting practice.

Blunder 9

Reporting flaws in the system

Background

The taxpayer-owned **Royal Bank of Scotland,** usually and tactfully called RBS, has had an unusually chequered history of computer, accounting and management errors in recent years. The most recent was incorrect interest (on the low side, naturally) being paid to some E-Isas accounts in its NatWest subsidiary – interest for these customers was only calculated from 29th of January to the 31st of January instead of the whole month of January.

> No one noticed it was a leap year

Other errors on the accounting and reporting front led to RBS being fined £5.6 million by the Financial Conduct Authority. It found that the bank had breached reporting rules on more than a third of its transactions on wholesale markets between November 2007 and February 2013. The bank failed to report properly on 44.8 million trades and failed to report at all on 804,000 transactions.

What went wrong?

The FCA said the bank's failings "are particularly concerning because the FCA already provides extensive guidance to firms on how to submit and check these reports…"

Lessons learned

Unfortunately in recent times it seems that RBS has more often made headlines due to blunders than for positive business performance.

As well as actual financial losses and fines by regulators and other authorities, business reputations are inevitably damaged by screw-ups: especially repeated screw-ups. If RBS had been private or publicly quoted or something other than a High Street bank, where would it be now?

RBS have said "we regret the failings that were uncovered and have subsequently made significant investments in our systems and controls in this area." In one sense it is better to be late than never but remember that repeated errors will damage your brand and skimping on proper controls will cost more than any savings in the long run.

Blunder 10

Doubling up

Background

In 2012 the **Department of Finance** in Ireland (notice the irony here) was forced to admit to an embarrassing error when an extra €3.6bn appeared on the State books.

It turned out that loans from the organisation which manages the nation's debt to a housing agency were counted twice, doubling the debt. The error was uncovered after the Department of Finance alerted the National Treasury Management Agency (NTMA) to a change in the way it deals with the Housing Finance Agency (HFA) which finances house buying for councils.

> The discrepancy arose because there was a change of status for the housing agency's borrowings

As a result the Secretary General of the Department of Finance had to appear before the Dáil's Public Accounts Committee.

What went wrong?

Basically, a duplication of effort by agencies, a breakdown in communication and reporting between these agencies and a lack of resources for key statistical work within the Department of Finance, led to the NTMA lending the €3.6bn and recording it as owed, while the HFA also recorded it as a debt on its books – thereby doubling the cost.

Lessons learned

The discrepancy arose because there was a change of status for the housing agency's borrowings, and although the NTMA referred to the change in covering letters, the references were not "sufficiently detailed" to be picked up by the statistics unit of the Department of Finance.

Whilst some problems do have a silver lining (the accounting error meant that the general government debt was reduced by 2.3pc of the GDP) the clear message is that communication is everything.

Afterword

We put these tales of accounting blunders together in a spirit of fun and hopefully also as a constructive stimulus to owners and managers in smaller businesses to keep a wary eye on their own business books.

A lot of these tales involve human error, which unfortunately can never be eradicated. We need to accept that. Sometimes this can relate to questions of judgement by senior and professional people. On a day to day level, mistakes such as entering an incorrect figure, for example, are just going to happen from time to time.

All modern bookkeeping systems aim to ensure that ledger entries need only be made once. Then they are carried through the rest of the systems electronically. That helps prevent the kind of errors that inevitably come with people re-keying information at a number of points. Our software incorporates a unique function - the ability to change or delete entries without the need to post reversing journals, coupled with an audit trail for transparency. This helps to cut down errors.

In all our years of developing our software, we have consistently taken the approach that keeping everything simple for users is essential to ensuring the minimum of errors. Our software today does many very smart things—and we have converted it as a SaaS (Software as a Service) cloud based alternative for businesses - but simplicity is still our proud boast. This is underlined by CIO magazine's enthusiastic review which commented that "Big Red Cloud's online accounting software has an edge in the marketplace; it offers simple, reliable and low cost accounting software without the complexities of some of the larger alternatives in the market."

It works from the get go and is backed by full telephone support. We provide an unlimited online subscription because if you're not going to put limits on your business, then neither should we.

Going to the cloud has a number of benefits

Going to the cloud has a number of benefits – the low capital expenditure to get up and running, ease of upgrading with everyone on the same version and even the smallest firm has the same technology at its disposal as the very largest.

If you and your business are not already with us, you might like to have a look at www.bigredcloud.com.

May I wish your business great success in the future.

Marc O'Dwyer
CEO

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