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## ***An Ethics Case***

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### Case 1.4

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## Loft Apartments

Loft Apartments, Inc., leases 900 one- to three-bedroom apartments in the suburbs of Atlanta, Georgia. It has as few as 50 and as many as 200 units in eight locations. The apartments are popular because each unit contains a loft that can be used as a study area, office, or bedroom.

In the last five years, business has been very good. However, Doug Baxter, the firm's controller and chief operating officer, can't explain why certain apartment complexes are having difficulties meeting payroll even though occupancy is high. This is especially true for the Marietta complex.

Doug graduated from a local university with an accounting degree. He was interested in real estate management and began his career with Loft Apartments, Inc., as a rental consultant. After two years, he became Marietta's accountant and operations director reporting to the general manager of the complex. He submitted monthly financial reports to this manager, who audited and forwarded the statements to the firm's controller. The controller consolidated the statements and provided copies to the firm's only shareholders, Kent and Cheryl Bianca. After Doug had been with the firm for 10 years, the Biancas promoted him to controller and chief operating officer.

In 1998, Amy Coldwell, the firm's vice president in charge of development and strategic planning, approached Loft's owners with an idea. She thought the firm's unique loft design and its construction system, which was owned by Kent and Cheryl, was sure to

succeed in other cities. Amy proposed a public offering of 100,000 shares of stock. The proceeds would be used to build apartments in the suburbs of Baltimore and New Orleans.

Kent asked for an opinion from longtime friend John Meckler, who worked with the investment banking firm of Johnson and Meriman. At their weekly lunch meeting, John said he and his firm would participate in the offering by providing capital and services only if Kent could assure him that Loft Apartments, Inc., was in solid financial condition. Kent told John that he would provide him with financial statements the next time they met.

The next day, Kent called Doug and asked him for financial statements for each of the last 24 months, as well as one- and two-year summaries. Kent said he was serious about pursuing Amy's expansion idea and needed financial statements that would support the stock offering. Kent also promised that Doug would receive 5 percent of the stock offering.

Doug worked on the request all day and into the night. On Tuesday night at 9:00, he left his office with the intention of driving straight home. However, he was still plagued by questions about Marietta's cash-flow situation. So, on the way home, he took a slight detour and drove past the Marietta complex. To his surprise, only about one-half to two-thirds of the apartments appeared to be occupied. This was contrary to what he expected, given the high occupancy-rate reports he received from Marietta's general manager, Paul Wentworth.

Doug had a restless night of sleep. When he arrived at work the next day, he called Lois Gennings, Marietta's accountant, and asked her to lunch. Like Doug, Lois had a degree in accounting and had passed the Certified Management Accountant (CMA) exam.

Doug showed Lois the consolidated statement he had prepared (see the end of this case study) and asked her whether she would attest to the Marietta portion of the statement. She was silent. He asked her whether the complex still had cash-flow problems. She responded, "Yes." He said, "How can that be? Your occupancy is very high." Lois looked at the floor while telling Doug that the figures for Marietta were inflated. She said

she submitted the correct report, but Paul Wentworth altered the figures so that the complex would show 90-percent occupancy. Paul received a \$10,000 bonus if this figure was attained. Lois said she didn't do anything for fear of losing her job.

Doug leaned back in his chair and said, "If you don't say anything, you will keep your job, I will recommend that you become operations director, and I will receive my 5-percent share." Lois told him she would keep quiet and left the lunch in a quandary.

**Loft Apartments, Inc.**  
**Atlanta, Georgia**  
**Monthly Income Statement**  
**3/31/20XX**

	<u>Total Units</u>	<u>3/31/20XX</u>
<b><u>Rental revenue:</u></b>		
Decatur	50	\$ 37,500
East Point	75	52,500
Marietta	200	130,000
Peachtree City	175	122,500
Riverdale	75	67,500
Roswell	150	97,500
Smyrna	50	50,000
Stone Mountain	125	<u>75,000</u>
Possible rental revenue		\$632,500
Less: Vacancies		<u>80,000</u>
Actual rental revenue		<u>\$552,500</u>
<b><u>Operating expenses:</u></b>		
Salaries and wages		\$113,850
Real estate taxes		63,250
Insurance		56,925
Utilities		44,275
Repairs and maintenance		<u>12,650</u>
Total expenses		<u>\$290,950</u>
<b>Operating income</b>		<b>\$261,550</b>
Less: Debt service		<u>145,980</u>
<b>Net income</b>		<b><u>\$115,570</u></b>