



THE MACY'S ACCOUNTING FRAUD CASE

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Abstract

This case describes a real-world fraud involving the retail department store Macy's, a publicly traded company on the NYSE. In late 2024, Macy's announced that they had discovered an accounting "error" in their financial statements. The discovery of the error forced Macy's to delay their third quarter earnings release. Macy's disclosed that a single employee had been falsifying accounting records for approximately three years, leading to financial statement restatements to correct delivery expenses, accruals and related tax effects. The error and restatements led to questions about internal controls at Macy's. It also leads to questions as to whether this was correctly called an error, or if Macy's should have described it as a fraud. This case examines the misstatement and its consequences, and can be used in an accounting or auditing classroom to help students understand errors and fraud, internal controls, ethical leadership, and regulatory requirements for publicly traded companies. Students will learn the importance of accuracy, transparency and ethics in record keeping and financial reporting. As we prepare students for the working world, these lessons in ethics will be more important than ever. This case is appropriate for an upper level undergraduate course or a masters level accounting or auditing course.

Keywords

Fraud, Restatements, Internal Controls, Ethics

1. Introduction

This case discusses a real-world fraud in a company that students will be familiar with. In late November, 2024, Macy's, a well-known American retail giant, announced that an internal investigation had uncovered an "accounting irregularity" (Macy's, 2024a). The investigation found that from late 2021 through the third quarter of 2024, a single employee had intentionally misrepresented approximately \$151 million in delivery-related expenses, concealing them over multiple fiscal periods. The fraud led to a material misstatement of Macy's financial statements and resulted in a two-week delay in the company's quarterly earnings report in November 2024.

The revelation of the fraud caused Macy's stock to plummet by 10.7% in premarket trading, wiping out approximately \$380 million in market capitalization (Kilgore, 2024). Following the announcement, Macy's also revised its profit outlook downward for the fiscal year, further damaging investor confidence. The company stated that the fraudulent activity was not motivated by personal gain but was instead an attempt to cover up an earlier accounting mistake.

This fraud case provides an example of how financial misstatements can impact a company's financial position, investor confidence, and regulatory standing. Understanding how and why fraud occurs and the controls needed to prevent and detect it, is essential for future accounting professionals. By completing this case, students will gain a deeper appreciation for the role of internal controls, tone at the

top, corporate governance, ethical leadership, and regulatory oversight in ensuring the integrity of financial reporting.

This case is appropriate to use in an undergraduate or graduate level auditing or fraud class. It is important that accounting students know and understand the impact of fraud on companies and markets, as well as the audit implications.

2. The Fraud

On November 25, 2024, Macy's issued a press release saying that, during the preparation of their unaudited third quarter financial statements, that they "identified an issue related to delivery expenses in one of its accrual accounts" (Macy's, 2024a). Macy's reported that a single employee, responsible for small package delivery expenses, made "erroneous" accounting entries over the course of three years to conceal a mistake. The individual, responsible for small package delivery expense accounting, intentionally made fraudulent accrual entries from the fourth quarter of 2021 through November 2, 2024, to hide these expenses. The concealed amount represented about 3.5% of the \$4.36 billion in delivery expenses recognized by Macy's during this period.

The fraud was discovered during an internal investigation, which was prompted by inconsistencies in expense reporting. Macy's launched an independent investigation and forensic analysis (Macy's 2024b). The employee who perpetrated the fraud told investigators that they had mistakenly understated the amount of small parcel delivery expenses in 2021. To hide this error, the employee continued to make fraudulent accounting entries and make fraudulent underlying documentation until the misstatement was discovered. It appears that the fraud was not for personal gain by the employee, but rather to cover up an earlier, unintentional accounting mistake. Macy's noted that the employee is no longer employed by the company and that the company did not identify involvement by anyone else.

It is interesting to note that Macy's refers to the accounting entries as "erroneous" as opposed to "fraudulent." However, PCAOB Auditing Standards 2401 says: "The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional... fraud is an intentional act that results in a material misstatement in financial statements that are the subject of an audit" (PCAOB, n.d.).

Over the course of the three years, from the fourth quarter of 2021 until the fraud was detected in November of 2024, the fraudulent entries totaled \$151 million dollars, which was about 3.5% of the \$4.36 billion in delivery expenses recognized by Macy's during this period. Macy's had to delay their third quarter earnings release by two weeks.

The fraud inflated net income due to underreporting expenses. Total misstatement to delivery expense for the first half of fiscal 2024 was \$9M, which was adjusted in total during Q3 2024. Macy's claimed impact was "not material" for prior periods. Since the error did not impact net sales, which Macy's believes is "a key financial metric of the users of the financial statements" (Macy's, 2024b), Macy's treated it as a "minor revision" for prior periods, and determined that it was not necessary to amend previously issued 10-Ks and 10-Qs. Using this approach, Macy's corrected the error in the Q3 current year comparative financial statements by adjusting the prior period information reported in those statements, as well as disclosing the "error" in those statements. Macy's said that the "error" was not material to any prior period. However, net income for FY 2023 was reduced by \$60M (from initially reported \$105M to \$45M, a 57% reduction) and pretax income was reduced by \$81M (from initially reported \$124M to \$43M) (Macy's 2024b). Other prior periods were also adjusted.

Macy's said the adjustment didn't impact trends in profitability (Macy's 2024b). However, it is important for students to note that profits were already trending downwards and this adjustment significantly increased the downward trend. The 2023 reduction was 1% of gross margin and 3.5% of EBITDA. The Wall Street Journal reported that many accountants were questioning whether this should have been reported as a "major revision," also known as a "Big R" (Maurer, 2024). A major revision would have required Macy's to restate the prior-period financial statements.

3. Impact on Internal Control Over Financial Reporting

For financial reporting purposes, Macy's is considered a large accelerated filer. As such, they are required to have management, as well as the independent auditors, assess and report on internal control over financial reporting. Since this accounting fraud was able to go undetected, it was determined that there was

a material weakness in Macy's internal control over financial reporting. According to SEC filings (Macy's, 2024b), the audit committee of the board of directors at Macy's determined that management's report on internal control over financial reporting could no longer be relied upon. Below is an excerpt from the filing (Macy's, 2024b):

"The material weakness was the result of deficiencies in the design of controls over delivery expense and certain other non-merchandise expenses, and the related accrued liabilities, whereby the design of the controls did not consider the potential for employee circumvention of these controls..."

The Company is committed to addressing the material weakness and has begun to implement changes designed to improve its internal control over financial reporting and to remediate the material weakness...

...the Audit Committee of the Board of the Company determined, based on the recommendation of management following its consultation with the Company's independent registered public accounting firm KPMG LLP, that management's report on internal control over financial reporting as of February 3, 2024, included in Item 9A of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2024 filed with the SEC on March 22, 2024 should no longer be relied upon. Additionally, KPMG LLP's opinion as to the effectiveness of the Company's internal control over financial reporting as of February 3, 2024 included within the Report of Independent Registered Public Accounting Firm in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2024, should no longer be relied upon."

4. Consequences of the Fraud

As noted, the fraud had an impact on both the financial statements and the report on internal control over financial reporting. Further, since Macy's executive officers' cash bonuses are tied to an earnings metric, the company determined that executives had been erroneously overcompensated by \$609,613. Some of this has already been clawed back, and the remaining amount will be recovered in fiscal 2025, in accordance with Macy's Clawback Policy (Macy's, 2025).

Though the fraud at Macy's was not catastrophic for the company, in some cases, accounting fraud can have far-reaching economic consequences that extend beyond the immediate financial loss reported by the company. When fraud is discovered, investors may lose confidence in the company's financial reporting, leading to stock price declines and increased volatility. This, then, can impact broader market indices, especially if the company is a major player in its sector. Companies involved in accounting fraud may face regulatory fines, increased legal expenses, and costly settlements with shareholders. Additionally, the need for enhanced compliance measures and stronger internal controls can result in higher operating costs. Fraudulent financial reporting can lead to a downgrade in a company's credit rating, making it more expensive to raise capital. Higher borrowing costs can constrain future investments and growth opportunities. As companies restructure to recover from accounting scandals, layoffs and operational cutbacks sometimes follow. Beyond the company itself, suppliers, vendors, and business partners may also experience financial difficulties due to disrupted operations or delayed payments. In addition, the external auditors may suffer reputational damage for missing the fraud and also missing the material weakness in internal control over financial reporting. This is why fraud prevention can be much more efficient than fraud detection. Companies should prioritize strong internal controls, an ethical tone at the top, an effective internal audit department, and a whistleblowing hotline.

5. Discussion Questions and Suggested Solutions

1. ***How did the accounting fraud at Macy's impact the company's financial statements, and which accounts were most affected?***

GAAP violations include improper expense recognition, failure to accurately disclose financial information, and violations of accrual accounting principles. The fraud understated expenses over multiple periods, affecting accounts such as operating expenses, accounts payable and accrued liabilities, and net income. The misstatement inflated profits and misled investors regarding Macy's financial health. Macy's had to revise their historical financial statements for 2021-2023

included in the Q3 2024 report to properly reflect the delivery expenses and their effect on net income (and the related tax effects). In addition, compensation expense was affected because Macy's had to claw back bonuses.

2. ***What ethical lapses allowed the fraud to occur, and how could a stronger ethical culture have prevented it?***

The lack of oversight, possible management complacency, and failure to question irregularities may have contributed to ethical lapses. A core ethical issue was a weak management tone at the top. At the time of the fraud, Macy's had a Code of Conduct that emphasized integrity and honesty, but those values do not appear to have been consistently promoted or enforced. As a result, it is possible that employees may have believed that management would overlook unethical conduct. In this case, basic internal control deficiencies, including lack of segregation of duties and review of accrual journal entries allowed weaknesses in internal control to be exploited, allowing the lone employee to make fraudulent journal entries and falsify supporting documentation without detection. If management had created a stronger culture of ethical leadership and accountability, the employee may have been more likely to have followed proper procedures and admit to and correct the original mistake, rather than conceal the errors and have to continue to conceal them for years.

Management may have been reluctant to investigate expense irregularities because executive cash bonuses were based on reported earnings.

The fraud also raises concerns about the effectiveness of Macy's whistleblower program. The Office of Compliance and Ethics at Macy's had an anonymous reporting program, but it appears that employees (other than the individual committing the fraud) were unaware of the irregularities or did not feel comfortable reporting them. A more robust ethics training program, including focus on the anonymous whistleblower program described in Macy's Code of Conduct, could have encouraged earlier reporting and detection.

3. ***Evaluate Macy's internal controls: what weaknesses may have contributed to the concealment of \$151 million in expenses?***

Internal control weaknesses include inadequate segregation of duties, poor review processes, and insufficient automated controls to detect inconsistencies in expense reporting. A single employee appears to have been responsible for preparing, posting and reviewing journal entries related to delivery expenses. As the fraudulent entries went on for years, it appears that there was a lack of review and approval of journal entries. There appears to be a lack of monitoring of internal controls, both by management and internal audit. Further, the tone at the top may not have been one to emphasize strong ethical behavior in financial reporting.

4. ***If you were an internal auditor at Macy's, what red flags or audit procedures might have helped detect this fraud earlier?***

If the internal audit department at Macy's had conducted a risk assessment of the small package delivery expense process, it would have indicated a significant control weakness due to the lack of segregation of duties. This alone likely would have indicated that an in-depth review of reported expenses should have been conducted. A suggested audit procedure would be to conduct a trend analysis of Macy's reported delivery expenses. The analysis could have indicated inconsistent expense trends. A comparative analysis of peer retailers' delivery expense trends could have further indicated anomalies that should be investigated. These findings may have shown red flags indicating that delivery expenses may not be accurately reported and additional audit procedures should be conducted.

A subsequent audit step should have been to test delivery expense journal entries for unusual and unsupported year-end adjustments, particularly those associated with accrual entries. Macy's may have neglected this procedure because the account consisted of low-value and high-volume transactions that fell below risk assessment thresholds. However, journal entry testing could have red-flagged inappropriate journal entries indicating potential fraud or financial misrepresentations.

Data analytics using software such as IDEA, ACL, or even Excel can help internal auditors to routinely monitor expense data for trends, outliers and potential fraud. These tools can provide a data-driven audit approach, allowing internal auditors to focus audit procedures on high-risk areas.

5. ***How did the revelation of Macy's accounting fraud affect its stock price and investor confidence, and what are the potential long-term financial and reputational consequences for Macy's following this fraud?***

The stock immediately dropped by approximately 10%, erasing \$380 million in market value. It is possible that investor trust declined due to concerns over Macy's financial integrity and management oversight. It is likely that the announcement of the fraud and restatement led investors to question Macy's governance and oversight, as well as the reliability of their financial reporting. The fact that the fraud went undetected for so long may have caused investors to lose faith in Macy's financial reporting and to question future earnings projections. The costs for the internal review and remediation and testing of internal controls over financial reporting should also be considered. Management needed to spend time and attention on controls, which could distract from growth initiatives.

The fact that Macy's referred to the issue as an "error" rather than a fraud is interesting and the instructor can choose to include this as part of the class discussion: Was Macy's correct in calling it an "error"? Should Macy's have called it a "fraud" in their press releases and regulatory filings? What would have been the impact of that change of wording?

Potential consequences include increased regulatory scrutiny, reduced investor confidence, higher audit costs, potential lawsuits, and reputational damage affecting sales and partnerships.

6. ***What role do regulatory bodies like the SEC and PCAOB play in addressing financial fraud cases like this?***

The Securities and Exchange Commission (SEC) is the federal regulator in the United States responsible for enforcing securities laws. Their role is to protect investors. They investigate financial misstatements and enforce penalties. The Public Company Accounting Oversight Board (PCAOB) is a non-profit corporation created by Congress as part of the Sarbanes-Oxley Act of 2002 to oversee audits of public companies. Before 2002, the auditing profession was self-regulated through a system of peer-review. The PCAOB also protects investors by seeking to ensure audit quality and compliance with financial reporting standards. The PCAOB has the role of inspecting the audit work and quality control systems of auditors of publicly traded companies, and also has the power to investigate and discipline auditing firms and individual auditors who violate laws, rules or professional standards.

7. ***What key takeaways from this case should accounting professionals and companies learn to prevent similar fraud in the future?***

Companies should strengthen internal controls, encourage ethical leadership including a strong tone at the top, support rigorous internal audits, and promote transparency to prevent financial misstatements. Segregation of duties, review of journal entries and monitoring of controls is essential. Employees should feel that if they make a mistake, they can go to their supervisor and report it to ensure that it gets corrected immediately, rather than feel that they have to cover it up. Employees should have regular training on ethics and be required to sign a code of conduct. Macy's includes a link to their Code of Conduct on their website, however, it is impossible to know how many employees are familiar with the Code.

Accounting professionals should recognize that fraud is prevalent, and that many frauds start small and snowball into bigger amounts that make it difficult to recover from. Accounting professionals should remember that the SEC offers whistleblower protections. Auditors are reminded to maintain professional skepticism. A key takeaway is that fraud prevention is not only about controls and compliance, it is also about culture and vigilance.

6. Learning Objectives & Implementation Guidance

This case is designed to be used in an upper-level undergraduate or graduate-level auditing or fraud course. The case study will allow students to:

- Analyze the financial statement impact of fraudulent accounting practices. (Question 1).
- Assess the ethical issues and internal control weaknesses that contributed to the fraud. (Question 2, 3).
- Understand the role of internal auditors, external auditors, and regulatory bodies in detecting and preventing fraud. (Question 4, 5, 6).
- Evaluate the consequences of accounting fraud for investors, stakeholders, and corporate reputation. (Question 5, 7).

When answering the discussion questions, students will need to combine their accounting knowledge with critical thinking skills as they examine the accounting fraud. Students will also be required to consider the ethical lapses along with the consequences of the fraud. Given that students are familiar with Macy's, the case provides an excellent illustration of real-world consequences when there is not proper segregation of duties and an adequate tone at the top. It is a good opportunity to remind accounting students that they will face ethical dilemmas during their careers. They may face pressure to overlook or cover-up irregularities, and this pressure can come from a variety of sources such as deadlines, management expectations or personal loyalties, but students should be reminded and understand that they have a duty to the public to uphold high ethical standards, even when it is not easy or convenient.

Depending on the course, the instructor may want to tell the class to locate Macy's Code of Conduct on the Macy's website and read the Code. This can lead to an interesting class discussion on the purpose of a code of conduct, and the importance of making employees aware of it.

This case has been used in an undergraduate auditing course as well as both a graduate-level auditing course and a graduate level fraud detection and deterrence course. We recommend assigning the case to students to read ahead of time. The instructor can briefly (5-10 minutes) introduce the case and assign it to be read over the course of the next 1-2 weeks. Then, in the designated class, we recommend breaking the students into small groups and assigning each group a question to discuss among themselves, and then present their answer to the entire class. We have found that students find the case interesting and appreciate learning how a fraud could occur at a company that they are familiar with, and how this impacts the company's financial reporting as well as the coverage in the press, and the implications for the company and auditing firms' reputations. It is important for accounting students to study real-world fraud cases so that they can transform theory into practical, ethical awareness and be prepared for careers that require trust from the public.

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