

The Misallocation Dilemma

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Accounting students experience an ethical dilemma through the lens of a recently degreed non-certified accountant working in his Uncle's construction company where nepotism is a factor. Students identify an ethical dilemma, critically analyze alternative courses of action and recommend a course of action. This case is unlike most ethics teaching cases where the accountant is not by a professional code of ethical conduct such as the American Institute of Certified Public Accountants' (AICPA) Code of Professional Conduct (AICPA, 2018). Students are exposed to the Giving Voice to Values (GVV) framework (Gentile, 2012) as an alternative to address an ethical dilemma.

INTRODUCTION

An overarching goal for accounting students and professionals is to establish patterns of ethical decision-making. Students learn principles of ethical behavior from accounting textbooks (Duska, Duska & Ragatz, 2011). Professional organizations, such as the American Institute of Certified Public Accountants (AICPA) and the Institute of Management Accountants (IMA) established professional codes of ethical conduct that provide certified accountants guidelines about how to address an ethical dilemma (AICPA, 2018; IMA, 2018). Certified/licensed accountants are required to complete continuing ethics education. However, in many companies, individuals completing accounting tasks are not certified accountants, and thus not governed by the AICPA or the IMA professional codes of ethical conduct. Nearly all cases and accounting texts presume, the protagonist is a degreed, certified accountant (public or management). While it is important for students to gain an understanding of the professional codes of ethical conduct, they also need to understand the appropriate actions for individuals not governed by such codes. In many instances, recently degreed accountants with limited experience blindly follow their predecessors' procedures which has the potential to create an ethical dilemma.

Research suggests that the use of teaching cases fosters an active learning environment affording students the opportunity to apply classroom knowledge to a quasi-real world problem (Lynch, 2008; Paolini, 2015) bridging the gap between academic and professional environments (Milne & McConnell, 2001). In recent studies of professional preparation, employers indicated accounting/business students lacked sufficient development in critical thinking, decision-making, judgement and soft skills (Ahmad & Michael, 2017; Jackling & De Lange, 2009). This case challenges students to identify an ethical dilemma in a quasi-real world setting, apply ethical concepts such as the Giving Voice to Values (GVV)

framework and the AICPA and IMA's professional codes of ethical conduct to recommend potential courses of action and evaluate the possible outcomes of each. This case designed to be covered in one class can be modified for use in a spectrum of undergraduate and graduate accounting courses and can be assigned as a written assignment or an in-class discussion.

The goal of this case is to give students an opportunity to explore the internal conflict associated with an ethical dilemma through the lens of a recently degreed non-certified accountant working in a family business. Through personal reflection and class discussion, students will be better equipped to address an ethical dilemma when they become working professionals. Feedback from 59 students enrolled in a graduate ethics course, auditing and introductory courses in the southwestern region of United States provides evidence about the case effectiveness in identifying an ethical dilemma while increasing awareness of multiple structured approaches to address it.

LITERATURE REVIEW

Over 30 years ago, the Bedford Committee called for the use of case-based learning in accounting curriculum (AAA, 1986). If used correctly, case-based learning provides students the opportunity to read and discuss complex real-life scenarios to engage higher order learning, such as critical thinking, problem solving, and reflective judgment (Sawyer, Tomlinson & Maples, 2000; Weil, Oyelere, Yeoh & Firer, 2001). Using case-based learning is an appropriate active learning technique when the instructor is able to give up control, and allow the students to struggle to arrive at a solution, then present and discuss the topic (Hassall & Milne, 2004). Teaching cases promote active learning and are an effective tool to advance and develop students' critical thinking and judgement skills (Meyers & Jones, 1993; Boyce, Williams, Kelly, & Yee, 2001; Fink, 2013). A "sandwich" approach has been suggested for teaching ethics in accounting. This approach would include a general ethics course, followed by integrating case studies on ethical topics into current accounting courses, and finally a capstone ethics course (Armstrong, 1993). This case adds to the literature by providing a tool to be used in the "center of the sandwich". Specifically, this case would be appropriate for undergraduate and graduate accounting students enrolled in ethics or auditing.

METHODOLOGY

The case was assigned as an in-class exercise towards the end of the semester to undergraduate and graduate students enrolled in accounting ethics, auditing and managerial accounting courses at universities in the Southwest.

Case Material

When cities in the Southwestern United States began to boom 30 years ago, Randy Holmes seized on the opportunity to establish All Pro Construction to manage long term construction projects. Historically, the company managed no more than 25 jobs at a time, but lately the number of jobs nearly doubled. While Randy welcomed the increased workload and profits, he knew it would strain on the company's resources. Since inception, Randy chose to keep employee's base pay low preferring to pay substantial yearend bonuses so long as all jobs were profitable. The pay structure seemed to function well with many employees working for the company in excess of 15 years.

With the recent success of the company, and the need for additional capital, Randy decided to pursue taking the company public through an initial public offering (IPO) something he contemplated for several years. All Pro's long time Chief Financial Officer (CFO), Sandy Smits was a casualty of Randy's plan. Nearing the end of her career, and wanting no part of the headache associated with an IPO, she chose to retire.

To replace Sandy, Randy hired Blanca Jimenez, a Certified Public Accountant, with five years of construction industry experience with a publicly traded company. Having joined the company seven months ago, Blanca was still learning. She realized her primary responsibility was to ensure the

company's financial statements were accurate and fairly represented the company's operations in preparation All Pro's much anticipated IPO.

The Meeting

After completing her review of the transaction processing departments (accounts payable, accounts receivable & payroll), Blanca felt comfortable that the appropriate procedures and controls were in place to pay vendors, invoice customers, accept payments, and pay employees. She saved the most challenging review for last--the company's procedure for allocation of construction overhead costs to jobs. After an initial review, she was concerned for the last three years one construction job consistently exceeded 100 percent complete.

Bianca summoned Duke Holmes, the Construction Accounting Manager, to her office to discuss the procedure. Duke recently completed his accounting degree and began work for his Uncle Randy as a Staff Accountant. After two short years of experience, Duke was promoted to his current position with responsibility to allocate construction overhead costs to jobs. Prior to his meeting with Blanca, Duke had never considered the procedure. After his promotion, he simply continued to maintain and update his predecessor's spreadsheet with input and guidance Randy's daughter, Mary, the Construction Department Manager.

Blanca looked deep in thought when Duke entered her office, "Duke, I am certain you are aware we are preparing for an IPO next year."

"Yes. I am very excited. My uncle is going to reward all family members and loyal long term employees with a one thousand shares of stock each in the corporation."

"That's great. I would be excited too. As part of the IPO preparation, I am reviewing all company procedures. The last thing I need to review is your procedure for allocating construction overhead costs to jobs before we engage a CPA firm to audit our financial statements."

"OK. How can I help?" Duke asked.

"In analyzing the construction job cost reports for the last three years, something seems amiss. There was one job that consistently exceeded 100 percent complete. Can you help me understand why?" Blanca inquired.

Duke, realizing he did not fully understand the procedure hesitated as he replied, "I'm not certain Blanca. Can I get back to you in a couple of days? I need to analyze the spreadsheet."

"Sure, whenever you are ready is great," she responded.

The Discovery

For the first time ever, Duke began to analyze how construction overhead costs were allocated to jobs. When he was promoted, Duke recalled a conversation with Mary about how to use the "cookie jar". When making his final allocations, Mary directed him to allocate money from construction jobs with overages to the "cookie jar" so that all jobs were profitable. She explained that the "cookie jar" was a job that had the lowest costs and highest margins, and was always excluded in the calculation for yearend bonuses. It made sense at the time, but now Duke began to question Mary's motivation. He realized that if ALL jobs including the "cookie jar" were not profitable All Pro's employees him included would not be awarded their customary annual yearend bonuses. He was fearful his misallocation of construction overhead costs might adversely impact All Pro's highly anticipated IPO or much worse if his lack of understanding of the allocation process was exposed, he might be demoted or fired.

Requirements

Respond to the following case discussion questions to guide Duke in addressing his ethical dilemma.

Case Discussion Questions

1. What ethical dilemma is Duke facing?

2. What code(s) of ethical behavior govern Duke's ethical dilemma? How would your answer change if Duke were a Certified Public Accountant or Certified Management Accountant?
3. Who are the stakeholders and what is the impact of misallocation of construction overhead?
4. Evaluate Duke's potential responses to this ethical dilemma and the advantages and disadvantages of each. For you, which is the best response and why?
5. What impact does nepotism and Duke's lack of knowledge of the procedure to allocate construction overhead costs to jobs have on his ethical dilemma?

CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Objectives

The case uses a private, family-owned and operated construction company to highlight an ethical dilemma faced by a family member, degreed non-certified accountant. While the case is a departure from how a certified accountant (Certified Public Accountant or Certified Management Accountant) governed by a professional code of ethical conduct approaches an ethical dilemma, it provides students the opportunity to envision how a non-certified accountant would face an ethical dilemma. Understanding the internal conflict arising from a "quasi" real world ethical dilemma in an educational setting provides students with context that can be applied to their professional careers. The objectives of the case are as follows (Bloom et al., 1956):

Knowledge- Students will increase their knowledge of accounting ethics to articulate the ethical dilemma faced by a non-certified accountant completing accounting procedures.

Understanding- Students will develop an understanding of the internal and external pressures associated with an ethical dilemma and their impact on decision making.

Application- Students will apply their knowledge of general ethical frameworks such as GVV, and accounting ethics codes including the AICPA's Code of Professional Conduct and the IMA's Statement of Ethical and Professional Practice to a "quasi" real world ethical dilemma.

Evaluate and Analyze- Students will evaluate and analyze the most likely courses of action when confronted with an ethical dilemma and the likely consequences with each course of action.

Implementation

The case forces students to evaluate the potential responses (remain silent, resign or disclose) to an ethical dilemma. The case allows for the deployment and discussion of deploying the GVV framework (Gentile, 2012), as well as the AICPA's (2018) and IMA's (2018) professional codes of ethical conduct. The first question ensures students understand the ethical dilemma before proceeding to address their potential responses. The remaining questions could be assigned as an out of class written exercise to be completed individually or discussed in an in-class exercise. Prior to discussing the case, it is imperative students have an understanding of the GVV framework and the AICPA and IMA codes of ethical conduct. In class discussion enhances case student learning when they discuss differing perspectives to an ethical dilemma.

CLASSROOM TESTING

The summary of Table TN-1 Panel shows a mean and a median for all courses supporting the case effectiveness in attaining learning objectives and students' perspectives of suitability. While the sample size was small (59 students), they represented a cross section of undergraduate and graduate students

studying multiple accounting disciplines. Overall their scores universally suggest that the case was an effective teaching tool and positively impacted student learning outcomes. As part of the survey, students provided anonymous written feedback supporting their survey responses. A sampling of student responses is presented in Table TN-2. The students' comments suggest they enjoyed the "quasi" real world situation and the impact of nepotism in the workplace while enhancing critical thinking skills.

**TABLE TN-1
CASE VALIDATION RESULTS**

| | Undergraduate Managerial Accounting N = 19 | Graduate Ethics N = 14 | Undergraduate Audit N = 26 | Overall N = 59 |
|---|---|---------------------------------------|---|---------------------------|
| Learning Objective / Question | | | | |
| L.O. #1: Knowledge: Use knowledge of accounting ethics to articulate the ethical dilemma faced by a non-accountant completing accounting procedures. | | | | |
| o The case enhanced my knowledge on how to evaluate an ethical dilemma that I had previously not considered. | 3.74 | 4.05 | 4.05 | 3.95 |
| o The case made me aware of the ethical standards governing Certified Public Accountants and Certified Management Accountants. | 3.50 | 3.79 | 3.93 | 3.74 |
| o The case challenged my thought process and perspective on how to approach an ethical dilemma. | 4.27 | 4.19 | 4.46 | 4.31 |
| L.O. #1 Average | 3.95 | 3.74 | 4.31 | 4.00 |
| L.O. #2: Understanding: Develop recognition of the influences of personal connections and the impact they have on actions of parties involved in an ethical dilemma. Develop an appreciation for the need of filtering responses of parties to an ethical dilemma. | | | | |
| o The case helped me understand the importance of evaluating inputs from several perspectives when confronted with an ethical dilemma. | 3.79 | 4.05 | 3.58 | 3.81 |

| | Undergraduate Managerial Accounting N = 19 | Graduate Ethics N = 14 | Undergraduate Audit N = 26 | Overall N = 59 |
|---|---|---------------------------------------|---|---------------------------|
| o The case helped me understand how personal relationships impact, inform and influence personal ethics. | 3.79 | 4.29 | 3.86 | 3.98 |
| o I have a heightened understanding of the challenges of evaluating an ethical dilemma and the implications of possible responses. | 4.50 | 4.38 | 4.35 | 4.41 |
| L.O. #2 Average | 3.81 | 3.98 | 4.41 | 4.06 |
| L.O. #3: Application: Apply knowledge of the resolution of ethical conflict section of the American Institute of Certified Public Accountants Code of Ethical Conduct and the Institute of Management Accountants' Statement of Ethical Professional Practice to determine the appropriate course of action when confronted with an ethical dilemma. | | | | |
| o The case gave me an opportunity to practice and apply my personal ethics taking into account the ethical standards from professional accounting groups. | 3.95 | 3.86 | 4.35 | 4.05 |
| o I feel more capable apply my ethics knowledge and the professional accounting ethical standards than before I completed the case. | 3.89 | 3.86 | 4.23 | 3.99 |
| L.O. #3 Average | 3.92 | 3.86 | 4.29 | 4.02 |
| L.O. #4: Analysis and Evaluation: When faced with an ethical dilemma, analyze judgments, and make recommendations on courses of action and the consequences associated with those recommendations. | | | | |

| | Undergraduate Managerial Accounting N = 19 | Graduate Ethics N = 14 | Undergraduate Audit N = 26 | Overall N = 59 |
|--|---|---------------------------------------|---|---------------------------|
| o The case informed me on how to analyze and interpret comments from parties to an ethical dilemma. | 3.63 | 3.64 | 4.19 | 3.82 |
| o The case challenged me about making a recommendation when faced with an ethical dilemma. | 3.58 | 4.07 | 4.42 | 4.02 |
| o The case increased my ethical awareness and provided me insight into making judgments when confronted with an ethical dilemma. | 3.79 | 3.93 | 4.42 | 4.05 |
| L.O. #4 Average | 3.67 | 3.88 | 4.35 | 3.96 |
| Overall Case Effectiveness | | | | |
| o The case seemed realistic. | 4.16 | 4.21 | 4.73 | 4.37 |
| o The case was interesting to read. | 4.11 | 4.00 | 4.50 | 4.20 |
| o The case was a useful learning exercise. | 4.16 | 4.07 | 4.85 | 4.36 |
| o I would recommend my professor use this case again in future classes. | 4.05 | 3.93 | 4.62 | 4.20 |
| Overall Case Effectiveness Average | 4.12 | 4.05 | 4.67 | 4.28 |

TABLE TN-2
REPRESENTATIVE SURVEYED STUDENTS' ANONYMOUS COMMENTS (UNEDITED)

The following are students' replies to the question: "*What did you like about this case?*"

Real world:

That it was interesting situation that could happen in the real world.

It is realistic

It seemed like a situation that might commonly happen in the real world

The case was very realistic and useful in today's (sic) work world.

Critical thinking:

Provide a good topic to talk about the grey areas in ethical decision making

That it helped me understand that having relatives work in the same place can cause these pressures.

I would make sure there are correct answers to the case given to students after completing the case questions, in order for us to see if our answers are correct and what that we are studying the right information.

Talk more about if it happens what you should be doing rather than just give you options

I enjoyed how the problem made me think about multiple aspects of the case, such as nepotism and ignorance and how that can lead to fraud.

Nepotism:

I like that it gives a somewhat realistic view of nepotism in small companies. There are a lot of family businesses where a lot of the employees aren't necessarily qualified, so when they are asked a question they don't really know, but just follow a system.

The fact that it was very realistic and this scenario most likely happens in the private family owned business a lot.

It used nepotism into the problem and that isn't seen very often.

I liked that it brought up the idea of hiring family, because many companies tend to do that no matter if that family member has the background to do that job.

CONCLUSION

For accounting students to understand how they would react to an ethical dilemma in their careers, they need practice identifying and responding to an ethical dilemma. This practical case engages students in applying ethical concepts to a "quasi" real world ethical dilemma. Students' survey responses to case validation questions and their anonymous unedited comments demonstrate the case achieved the intended learning objectives.

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APPENDIX 1

TEACHING NOTES

Question 1. *What ethical dilemma is Duke facing?*

Duke realizes that he has been following the prior procedure for allocating construction overhead to jobs without understanding the process or the effect of the adjustments. He must decide whether to reveal his lack of understanding or try to bluff his way through the review.

Duke also realizes Mary's advice regarding adjustments to allocation of construction overhead to jobs utilizing the "cookie jar" was incorrect. If he discloses that information, it may adversely impact All Pro's pursuit of the IPO, the payment of year-end bonuses and his employment with the company.

Questions 2. *What code(s) of ethical behavior govern Duke's ethical dilemma? How would your answer change if Duke were a Certified Public Accountant or Certified Management Accountant?*

Since Duke is not a CPA or CMA he is not governed by their codes of ethical conduct. As an employee, Duke should consider the company's values in addition to his personal values and consider how his personal interests might conflict with what is best for the company. One approach he may elect to follow is the GVV framework.

Created for business ethics programs, the GVV framework identifies the multiple ways an individual can and do voice their values in the workplace. The foundation of GVV is to provide strategies to individuals to discover motivation skill and confidence to "give voice to their values" as it pertains to their personal and professional life (Gentile, 2012). The goal of GVV is to act consistently with our most deeply held convictions about right and wrong. Research and experience demonstrate that values conflicts will inevitably occur in our professional and personal lives. So, when what we believe and want to accomplish seems to be in opposition to the demands of others (peers, supervisors, organizations, etc.), the ability to successfully voice our values and navigate these differences is crucial. This is the starting point for the GVV curriculum.

GVV consists of seven principles, or pillars, that represent ways of thinking about values, our identity, and our own capabilities. The seven pillars of GVV are: *Values, Choice, Normalization, Purpose, Self-Knowledge & Alignment, Voice, and Reasons & Rationalizations*. The GVV framework can serve as a catalyst for further discussion of ethics and values.

If Duke were a CPA, he would be governed by the six principles established by the AICPA Code of Professional Conduct as follows:

- a. **Responsibilities**
 1. Maintain ethical judgement and exhibit professionalism in areas that are confidential.
 2. Cooperate with other accountants
 3. Preserve the public's confidence in CPAs
- b. **The Public Interest**
 1. Honor and serve the public
 2. Use integrity when conflicts of interest occur within the public community
 3. Responsibility to the public is a priority in order to maintain trust within the profession
- c. **Integrity**
 1. Maintain integrity and client confidentiality
 2. Providing public trust and avoiding choices for personal gain
- d. **Objectivity and Independence**
 1. Avoiding conflicts of interest to reach impartial decisions

2. Maintaining independence in fact and appearance for assurance services
 3. Prevent subordination of judgement
- e. **Due Care**
1. Continually improve the quality of services and competency through education and experience
 2. Strive for excellence by performing to the best of one's ability
 3. Adequately plan and supervise services
 4. Ask for referrals if professional services exceed one's competence
- f. **Scope and Nature of Services**
1. Utilize professional judgement to determine if services can be provided with integrity, competence, quality, and independence (in audit/assurance circumstances).

If Duke were a CMA, he would be governed by the four ethical standards of the IMA's Statement of Ethical and Professional Practice as follows:

- a. **Competence**
1. Maintain an appropriate level of professional leadership and expertise by enhancing knowledge and skills.
 2. Perform professional duties in accordance with relevant laws, regulations, and technical standards.
 3. Provide decision support information and recommendations that are accurate, clear, concise, and timely. Recognize and help manage risk.
- b. **Confidentiality**
1. Keep information confidential except when disclosure is authorized or legally required.
 2. Inform all relevant parties regarding appropriate use of confidential information. Monitor to ensure compliance.
 3. Refrain from using confidential information.
- c. **Integrity**
1. Mitigate actual conflicts of interest. Regularly communicate with business associates to avoid apparent conflicts of interest. Advise all parties of any potential conflicts of interest.
 2. Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
 3. Abstain from engaging in or supporting any activity that might discredit the profession.
 4. Contribute to a positive ethical culture and place integrity of the profession above personal interests.
- d. **Credibility**
1. Communicate information fairly and objectively.
 2. Provide all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.
 3. Report any delays or deficiencies in information, timeliness, or internal controls in conformance with organization policy and/or applicable law.
 4. Communicate professional limitations or constraints that would preclude responsible judgement or successful performance of an activity.

Questions 3. *Who are the stakeholders and what is the impact of misallocation of construction overhead?*

The stakeholders of the company consist of the following:

| <u>Internal Stakeholders</u> | <u>External Stakeholders</u> |
|--|---|
| Employees, Randy, Blanca, Mary, Duke, Management | Potential Stockholders, Banks, Vendors, Suppliers, IRS/Government |

The stakeholders listed are only representative of a much larger list of stakeholders. Students might suggest that Randy and Duke’s extended family (aunts, uncles, & cousins) also could be stakeholders. How Duke reacts to this ethical dilemma can profoundly impact anyone directly and indirectly connected to All Pro.

Question 4. *Evaluate Duke’s potential responses to this ethical dilemma and the benefits and consequences of each. For you, which is the best response and why?*

Remain Silent: Duke could remain silent about his involvement of misallocation of construction overhead to jobs. This response would allow him to remain employed at All Pro in the short term. In the long term, not reporting the potential issue, Duke could ultimately lose his job or be demoted if/when his misallocation of construction overhead is exposed.

| | |
|---|---|
| <u>Short-term benefits-</u> Financial stability Maintaining his status quo Continued positive professional reputation in the company | <u>Long-term benefits-</u> None |
| <u>Short-term consequences-</u> Guilt Resentment towards those who “tricked” him | <u>Long-term consequences-</u> Stress and physical complications Company growth plans may be hindered |

Resign: Duke could resign from the company without reporting the misallocation of construction overhead to jobs. This response would be completely out of character considering Duke has been with the company for a relatively short period-of-time and would find it difficult to find another accounting job with his limited accounting experience or professional certification.

| | |
|--|--|
| <u>Short-term benefits-</u> Avoids confronting the issue | <u>Long-term benefits-</u> |
| <u>Short-term consequences-</u> Guilt for not doing what is right Possible financial difficulty Misallocation will be discovered by another Pressure to find a new job | <u>Long-term consequences-</u> Family relationships may be harmed Starting over |

Report: Duke could report the situation to his Uncle Randy.

| | |
|--|---|
| <p><u>Short-term benefits-</u> A clear conscience</p> | <p><u>Long-term benefits-</u> Earning an ethical reputation Family harmony Building character</p> |
| <p><u>Short-term consequences-</u> Hatred from other employees Loss of job Demotion Difficulty making financial ends meet Stress</p> | <p><u>Long-term consequences-</u> Economic issues within the community Loss of friendships</p> |

For most students, there is no clear best response. While each response has short and long-term benefits and consequences. In this case, it depends on the value a student places on family harmony and personal relationships. Inevitably, Duke’s misallocation of construction overhead to jobs will be exposed with the company’s IPO plan. Some students may elect to avoid the ethical dilemma by either resigning from the company or remaining silent.

For many students, this ethical dilemma may be the first time they are confronted with a question where there is no clear correct response. On this critical question, instructors may elect to divide students into groups representing the three potential responses realizing the groups will probably not be the same size. Instructors may observe once the students are placed in their respective groups that they “voted” for their response. Each group is directed to discuss among themselves and then provide a summary to the class as to why and how they decided to pursue their selected response.

Question 5. *What impact does nepotism and Duke’s lack of knowledge of the procedure to allocate construction overhead costs to jobs have on the ethical dilemma?*

For Duke, being the company owner’s nephew creates an additional level of internal conflict. Even though it is not clear from the case, it is quite likely Duke was hired and subsequently promoted based on his family connections. If were not for his family connections, Randy’s level of expectation for professionalism, performance and accounting knowledge from Duke might have been elevated. A more careful vetting/application process might have been used. Like many recently degreed accountants, Duke placed trust in others including his cousin Mary and the accountant who proceeded him, which resulted in his failure to understand the intricacies of the procedure to allocate construction overhead to jobs. Further, Randy trusted Duke to do what is right for All Pro. However, Randy might not have promoted Duke so quickly if he was a non-family member.