

Good Intentions at Good Grains, Inc.

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ABSTRACT

This case addresses the “gray” area associated with the use of accounting discretion as it relates to expense line item reclassifications. Such a context allows for an examination of the pressures that influence accounting decisions and provides a glimpse into how managers might manage reported expenses. The reader meets analyst David Johnson when, as a result of both internal and external pressure to keep research and development (R&D) costs within budget, he is asked to find ways to reclassify R&D costs into other expense areas. As a result of the request, David immerses himself in the task in order to identify, within generally accepted accounting principles (GAAP), opportunities to reclassify R&D expenses to cost of goods sold. He ultimately proposes three separate reclassification entries that though technically within GAAP guidelines, involve the use of accounting discretion. All three entries are approved by the accounting team. Financial accounting, managerial accounting and MBA students report that the case enhanced their knowledge of financial reporting, and helped them understand ethical considerations associated with the preparation of financial statements. Accounting professionals report the case realistically depicts what accountants face in the workplace. A case extension using International Financial Reporting Standards is also provided.

KEY WORDS: earnings management, accounting discretion, business ethics, financial reporting, expense reclassification, International Financial Reporting Standards (IFRS)

General Background Information

In May 2010, David Johnson earned his Bachelor of Science degree in finance from Central State University. At the time he entered college he assumed that he would be able to leverage his education into a great entry-level position in investment banking or finance. However, while he was in college, the US economy went into a recession that reduced the number of entry-level jobs for college graduates. During his senior year, David doubled and redoubled his job search efforts and applied to many manufacturing and consumer products companies he had not previously considered. Two weeks prior to graduation he was finally offered his current job as a financial analyst at Good Grains, Inc. He started in June 2010 and for the past year he has been concentrating on performing all aspects of his job to the best of his abilities.

David finds his finance background useful when he's working on many aspects of his job responsibilities. Over the past six months he has tracked product promotion expense, analyzed overhead, and compiled information related to inventory costs and research and development (R&D) expenses. But he knows he still doesn't understand how Good Grains' strategy impacts each of these line items on the financial statements, and he realizes he knows very little about US generally accepted accounting principles (GAAP) and the Securities and Exchange Commission's (SEC) requirements for public companies. His career mentor, Good Grains' Chief Financial Officer (CFO), encouraged him to enroll in the accounting master's degree program at the local university. David knows that he's working in a very competitive work environment and decides to take the advice. He hopes the additional knowledge that he acquires

throughout the program will help him excel at his job. Ultimately this should help him increase his chances for regular promotion and annual bonuses. Given the state of the economy and the number of his friends who are still looking for full-time jobs, David is willing to invest whatever time and effort it takes to be recognized as a good performer at Good Grains.

Good Grains' Healthy Cereal Initiative

One reason David was attracted to Good Grains is its reputation for nutritious, high-quality grain-based foods. As a child, he loved Good Grains' cereals, and he always tried to convince his mom to buy as many boxes of the different varieties as possible. His birthdays and half-birthdays brought the special treat of one of the really fun cereals, the ones his mom said had too much sugar on their regular shopping trips. Remembering back to those special treats, he thinks it's great that Good Grains' R&D department is hard at work to reformulate many of the cereals. Their stated goal is to lower the sugar and increase the whole-grain content of the top 25% of the product line while maintaining the same taste and texture that consumers have come to know and love. David knows R&D is expected to develop and taste test production-ready product within the next nine months. David hopes the R&D department can deliver. He knows that Good Grains' competitors are also working to reduce the sugar content of their breakfast offerings. Given the public's current focus on good value and more healthy foods, Good Grains' management group is convinced that the first major producer to deliver a great tasting, lower sugar content product is sure to control the majority of the cereal market.

The Good Grains' Healthy Cereal Initiative was spearheaded by its president, a savvy market analyst. She convinced the Board of Directors to make significant investments in new product lines. She clearly understands the importance of successfully achieving the R&D targets. David has heard a few rumors that she is now facing additional pressure from both the Board and

Wall Street analysts to increase Good Grains' return on investment (ROI). David understands that the past three years' investments in new product lines were expected to improve gross margins and increase the company's profitability. He's a little unsure about some other things he's been hearing, most importantly, comments about how Good Grains continues to try to manage its financial results to meet Wall Street's expectations.

The Coffee Chat

One morning David was refilling his coffee cup when Good Grains' Controller, Rebecca Carey, walked into the break room. David always enjoyed talking with Rebecca. His co-workers told him she's the one who went to bat for him after he interviewed at Good Grains, and he appreciates her faith in him. Besides that, he respects her ability to communicate the complexities of the business and how they are reflected in the financial statements. David asked her if she had just a few minutes to explain how the pressure from the Board and Wall Street's expectations might impact Good Grains' activities through the end of the year.

Rebecca said Wall Street analysts track line items such as revenue growth, gross profit, and operating income in addition to ROI and earnings per share. They also analyze specific expense line items, including cost of goods sold, selling, general and administration, and research and development as a percentage of revenue and in comparison to industry averages. In order to achieve the financial target ratios communicated to both the Board and the analysts, Good Grains' CFO sets tight internal targets for each expense category. If the company does not meet these targets, Good Grains' stock price may suffer. David nodded his head and thanked her for the explanation. He now understands why he spends so much time analyzing ratios and tracking budget and actual expenses.

A Few Months Later

A few months after the coffee chat, Rebecca stopped by David's cubicle. "There's something I'd like to talk about with you. Do you have a few minutes?" she asked. Rebecca had never visited David's cubicle; he was amazed to see her there. He invited her into his small space, wondering about the visit. Rebecca began the conversation by stating that sales are holding steady, and upper management believes Good Grains' annual revenue will exceed \$200 million for the first time in its history. Its net profit before taxes is projected to be \$22 million, slightly higher than the industry average. However, there is concern that difficulties with the R&D effort will likely result in higher than budgeted expenses in this area. Although everyone acknowledges that both reduced sugar content and increased whole grains improve the nutritional value of the cereals, R&D discovered many additional personnel hours are going to be needed to make the cereals as crunchy as they are with the old ingredients. Good Grains had budgeted R&D expenses at 4% of revenues, a higher rate than usually found in the cereal industry. Management now anticipates that R&D expenses could be as high as 5% of revenues. Because of the focus on meeting the Board and Wall Street's expectations, Good Grains' CFO is hesitant to increase its reported R&D to the amount that will likely need to be incurred.

Rebecca asked if David can find a way to justify reclassifying R&D costs into other expense areas since most of those areas are under budget. She specifically mentioned that cost of goods sold (COGS) is coming in significantly under budget for the year, and asked David to look for any R&D spending that might be reclassified as COGS. David understands the importance of the new recipes and wants the new products to come to market. He is also beginning to understand the importance of meeting Wall Street's expectations, and how difficult it can be to

meet them. He asked Rebecca if he could have a few days to analyze R&D costs and the related accounting guidance and then meet with her to present his recommendations.

David's Response

David carefully reviewed Good Grains' accounting policies pertaining to research and development. The one pertinent paragraph in the policy manual reads as follows:

Direct and indirect costs associated with research and development efforts should be expensed in the period during which they are incurred.

Although David was surprised the policy manual didn't include more specific guidance, he hadn't read any other companies' manuals and therefore wasn't aware if it was customary to include more details.

He next discussed the R&D process with personnel in that department. David learned that R&D is conducted in two stages, and that the two stages involve very different types of activities. First, scientists in the corporate R&D center conduct research into the properties of different grains and sweeteners to determine viable substitutes for the current ingredients. Small test batches of possible new recipes are developed and produced in the R&D center test kitchen. This is a time-consuming process as the product is subject to many quality control tests following the production of each test recipe. It is only after the technical staff determines they have an appropriate and similarly-tasting higher grain and lower sugar recipe that the R&D process is moved to the cereal manufacturing facility for further production testing. David learned that the work went well in the test kitchen, and the testing was moved to the production line about six months ago.

He next talked with the production staff to learn about the R&D process there. He learned that the success of the small batches produced in the test kitchen was not carried over to the larger batch sizes required on the production line. The production staff finds the cereal batter

often clogs the equipment while being formed into the traditional product shape. Even when the product is appropriately formed, a small variation in cooking temperature causes the product to crumble. The production staff continues to work on the problems. They believe the process is improving and hope to resolve the problems within the next 90 days. In the meantime, a percentage of the test run batches that pass initial tests are released into the production stream. The quantity of the test run batches is small, so there is no discernible difference in the packaged cereal's taste or consistency. In the past these costs remained in R&D because they are not easily traceable. Once the newly formulated cereal is perfected, Good Grains will roll out the product with its newly designed packaging. Until then, the cereal will continue to be sold in the old boxes.

To document his understanding of the R&D process, David drew the diagram that appears in Figure 1.

Insert Figure 1 about here

After reviewing the R&D and production processes, David believed he could make a good argument to move estimates of the cost of the new product that passed quality control first to inventory since the product was made available for sale to customers, and then to COGS because the product was ultimately sold to customers. Effectively, inventory is first debited and R&D expense is credited. Then COGS is debited and inventory is credited. Like most other companies in the cereal industry, Good Grains' values its inventory using the LIFO method. This means that the reclassified costs will be expensed in the same period they would have been expensed if classified as R&D.

David once more met with the production personnel to determine the percentage of new cereal that passed quality control. The production manager estimated that between 10 to 25% of

the new product was included in the production stream since the manufacturing was moved to the production area. The percentages result in cost estimates ranging from \$300,000 to \$750,000. David watched a day's production and determined that 25% is a better estimate than the 10%. As such, he proposed the following journal entry:

| | | |
|-----------|----------------------------------|----------|
| Inventory | 750,000 | |
| | Research and development expense | 750,000. |

David carefully summarized the rationale behind his proposed reclassification entry. Although he believes he fully understands the processes and the cost implications, he had some concerns the accounting team would discount his suggestions. He was relieved when he realized one of the accounting team members grew up in the same neighborhood he did. While they weren't close friends, they belonged to the same swim club. He hoped their past relationship would make it easier to convince the accounting team to agree to his proposed R&D expense reclassifications. He reminded himself that reclassifying the amounts wasn't a violation of accounting policy; it was just a different policy interpretation from that currently used. A day after presenting his proposal to the accounting team, David was pleased to learn they agreed with the reclassification and recorded the entry.

A month later a review of the monthly profit and loss statements showed R&D expenses in line with budget, even though additional personnel had been added to the project. Unfortunately, more hours were still needed to keep the project on track. Rebecca once more met with David. She told him he did a great job moving R&D costs over to cost of goods sold and asked him if he could find additional amounts that could be reclassified. David once again reviewed the R&D and production processes to identify expenses that could be appropriately shifted to cost of goods sold. Most of these involved a very careful, and possibly aggressive,

interpretation of the expense classifications. For example, in the past, 100% of the cost to run the R&D department was allocated to R&D. But David learned that R&D personnel were responsible for the oversight of some of production activities when the new product was moved to that area. David felt confident he could argue his case for an additional set of journal entries with his new knowledge of how the R&D and production lines interconnected. He asked the R&D personnel for a summary of the time they spent in the production area, and determined estimates of their compensation costs that could be shifted from R&D to inventory, and then in turn to COGS. Since the R&D personnel didn't normally track how they spent their time, their estimates were pretty rough, ranging from 5% to 65% of their time. David calculated the amount that should be reclassified using a variety of different methods that resulted in R&D expenses ranging from \$125,000 to \$325,000 attributable to the production area. After reviewing all the information he had, he proposed the following reclassification entry that transfers R&D expense first to inventory, and then from inventory to COGS, once more resulting in the amounts being expensed in the period incurred:

| | | |
|-----------|----------------------------------|----------|
| Inventory | 300,000 | |
| | Research and development expense | 300,000. |

David once more met with the accounting team members. A more intense discussion of whether these reclassifications were appropriate ensued. Toward the end of the discussion, David's former neighbor brought up the SEC guidance on the classification of costs in the cost of sales category. That member reminded everyone that "as applied to inventories, cost means...the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location" (SEC 2000). The team agreed that this guidance suggests the cost of the R&D personnel overseeing the production process should be included in

COGS. However, there was additional discussion about the methodologies David used to determine the costs that should be included in inventory, at best they were estimates. In the end, they agreed that the R&D numbers could be changed based on David's second proposal.

The next month's financial results were good, but Good Grains' President and CFO determined that additional costs would be incurred during the last push to finish the product reformulations. Once more, David went searching for additional amounts that could be moved to cost of goods sold. This time he identified purchasing and receiving costs that were initially included in R&D, as well as internal material moving costs. These costs seemed consistent with the SEC guidance the accounting team cited during the last reclassification discussion. As such, these costs could be included as part of the cost of the product and moved to inventory and then moved to COGS because the test products were actually sold to the customers. Although he realized that some of the costs were probably associated with the R&D effort, David decided any true R&D costs reclassified to inventory/COGS would be considered small and immaterial, especially since more and more of the new product

David proposed the following reclassification:

| | | |
|----------------------------------|---------|----------|
| Inventory | 400,000 | |
| Research and development expense | | 400,000. |

David must have made a persuasive case as the accounting team agreed the change was consistent with corporate policy.

In summary, David's proposals reclassified a total of \$1,450,000 of R&D to COGS. The reclassified expenses approximate 6.6 % of income before income taxes. Reported R&D is expected to total \$8.55 million (4.3% of sales), rather than the \$10 million (5% of sales) that would have been reported without the reclassifications.

The Outcome

At year end, David was pleased that Good Grains' financial statements met the tight internal targets for both R&D and COGS. He was also pleased that the new products were on track for their launch in the next quarter. He was very happy with the results of his performance review prepared by Rebecca, and the complimentary email he received from the Company's president. He believes his work will be a positive factor when he's reviewed for a promotion at the time of his second annual performance review next year. By then he will also have completed the first half of his master's degree course work. So far, classes have gone well, and he is looking forward to his financial statement analysis class next semester. David is somewhat worried that next year's budget will reflect an even tighter R&D target and potentially lower spending in other discretionary expense areas. He hopes he is ready to take on the new challenges that will come with his new responsibilities.

A Few Weeks Later

David left on a vacation soon after the audited financial statements were released. As he sat on the plane waiting to take off, he thought back to the conversation in which Rebecca asked if he could find a way to reclassify R&D expenses to COGS, because that account was coming in under budget. He reflected on how difficult it was to find any clear authoritative guidance on what should or should not be included in either R&D expense or COGS, and the lengthy discussions the accounting staff engaged in when evaluating each proposal. He wondered if the reclassifications better represented Good Grains' financial position or simply moved expenses around to better meet Board and Wall Street expectations. He wished he knew more about what happened in other companies and how other financial analysts and accounting staff evaluated decisions of this nature. The flight attendant interrupted his thinking by asking him to please

buckle his seat belt. He did so, and then opened his magazine, deciding it was time to truly start his vacation.

DISCUSSION QUESTIONS

Please answer the following questions about the case. You may find there are few “correct” answers. Rather, you will need to apply judgment in developing your responses to many of the questions.

1. This case illustrates one situation in which the needs of operating managers (i.e., those managers responsible for responding to changing customer needs) and the desired financial results of a company may not align.
 - a. What is the business issue the company is dealing with in the case? Why is the management group focusing on the income statement line items?
 - b. What is the business issue with R&D? What is the accounting issue with R&D?
 - c. Do you think management should spend so much time on the presentation of the expense items in the income statement? What is gained or lost by focusing so much attention on the financial statements?
2. Rebecca is the Controller and has many years of experience with Good Grains.
 - a. What alternative actions were available to Rebecca, the CFO and President?
 - b. Why do you think Rebecca asked David to investigate what could be done to resolve the budgetary constraints?
3. Under US GAAP, each of David’s requests reclassify legitimate expenses from one expense category to another. There is no impact on the reported net income.
 - a. What was David’s incentive to find a solution to the R&D reporting problem? What was his reward?
 - b. What alternative actions could David have taken?
 - c. Good Grains values its inventory using LIFO, an option that is available under US GAAP, but not under International Financial Reporting Standards (IFRS). If US tax law is changed to eliminate the LIFO option, the GAAP treatment will likely also disappear. What is the likely affect of the reclassification entries if FIFO rather than LIFO is used? In assessing this question you may want to consider the industry average inventory turnover ratio is approximately 5.0.
4. Do you believe the reclassifications violated US GAAP for public companies? Be sure to provide appropriate references to support your answer.
5. Provide an ethical assessment of whether recording the entries as proposed is ethical or unethical. In your assessment you should consider incentives, intent, the interests of

stakeholders, characteristics of the journal entries themselves, and any other factor(s) that you considered in drawing your conclusion.¹

6. Assume that Good Grains completed its R&D project on a timely basis, and that consumer acceptance of the new products resulted in a 10% increase in sales revenue. Do good financial results change any potential negative implications of the reclassifications?

If this case is being used in an upper-level class, the following question can be added to enhance the research requirements for this case:

7. a. The FASB (2006) and IASB (2010) set forth the qualitative characteristics of useful financial information in their respective Conceptual Frameworks. The standard setting bodies agree the fundamental characteristics of useful information are relevance and representational faithfulness. Relevant information has predictive value, confirmatory value and is subject to materiality considerations. Financial statements that are a faithful representation of the underlying reality are complete, neutral and free from error. Enhancing qualitative characteristics of both fundamental qualities are comparability, verifiability, timeliness, and understandability.

Do you believe the reclassifications are consistent with the qualities identified in the conceptual framework? Be specific in your response, and provide examples from the case.

- b. What is the relevant authoritative literature pertaining to costs included in R&D, inventory and cost of goods sold? Please consult the applicable pronouncements of the FASB and the SEC. You may want to begin your research with FASB ASC 330 *Inventory* (FASB 2012), and the sections of Regulation S-X Chapter 5 that deal with the composition of inventories and income statements (www.sec.gov/about/forms/forms-x.pdf). Do you believe the reclassification entries comply with this guidance?

If this case is being used in an IFRS-reporting environment, the following question should be substituted for or added to question 3.

8. David's proposed reclassification entries assume US GAAP reporting. For the following questions, assume Good Grains reports using IFRS, and values its inventory on a FIFO basis.
 - a. Briefly explain the differences between US GAAP and IFRS in relation to research and development expenses. In addition to the US GAAP references identified in question 7b, you should review the content of *IAS 38 – Intangible Assets* (IASB 2004) and other pertinent IFRS resources available through your school's library.

¹ Instructors may want to refer their students to the Institute of Management Accountants' *Statement of Ethical Professional Practice* available at http://www.imanet.org/pdfs/statement%20of%20Ethics_web.pdf.

- i. How does the use of IFRS change the critical facts underlying the reclassification entries?
 - ii. If Good Grains were using IFRS rather than US GAAP, what distinction would you make between research and development?
- b. What effect do the reclassification entries have on the net income of Good Grains in the current year?
- c. What effect do the reclassification entries have on the net income of Good Grains in future years?

CASE LEARNING OBJECTIVES, IMPLEMENTATION GUIDELINES AND EVIDENCE OF LEARNING EFFICACY

Learning Objectives

After completing the case, students should be able to (1) identify research and development expenses; (2) identify costs associated with costs of goods sold; (3) understand the “gray” areas of expense line item classification within US GAAP; (4) understand accounting discretion within GAAP; (5) apply ethical reasoning within an accounting context; (6) analyze the influence of both internal and external pressures on accounting decisions; (7) hypothesize how and why managers might manage earnings; and (8) exemplify how knowledge of operations can influence accounting decisions. If this case is being used in an upper-level class the following learning objective is applicable: (9) select appropriate authoritative literature, including that issued by the SEC. If the case is used in an IFRS-reporting environment or a class focused on IFRS, the following learning objective is added: (10) recognize that the capitalization and subsequent amortization of development costs positively impacts Good Grains’ income in the current reporting period and negatively impacts future earnings.

As shown in Table 1, these learning objectives are readily mapped to the revised version of Bloom’s taxonomy of cognitive knowledge and cognitive process (Anderson and Krathwohl (2001). The cognitive knowledge dimension identifies the types of knowledge to be learned

(e.g., factual, conceptual, procedural, or metacognitive); the cognitive dimension identifies the processes used to learn (remember, understand, apply analyze, evaluate).

Insert Table 1 about here

Table 1 illustrates that the Good Grains, Inc. case provides students an opportunity to gain knowledge beyond the basic elements of accounting (e.g., identifying and recording expense journal entries). In utilizing factual accounting knowledge, the case provides students an opportunity to acquire conceptual knowledge (defined as the knowledge of categories and classifications of how to perform a task), procedural knowledge (defined as knowledge of how to do something), and meta-cognitive knowledge (self-knowledge).

In summary, the case learning objectives are accomplished by utilizing a case study that focuses on which expenses should be included in R&D and which should be included in cost of goods sold. The case is specifically designed for varying interpretations. Rather than being able to rely on a straight-forward application of GAAP, students are introduced to an area in which accounting decisions may be based on professional discretion, the contents of company accounting manuals, or industry norms. As such, they are provided with an opportunity to work through a decision process that involves both norms and rules underlying a financial reporting decision.

Implementation Guidance

The Good Grains case is loosely based on an actual event, one that may occur in many business operations. This belief is supported by the comments received from accounting professionals who used the case in a CPE class. Some stated the case realistically portrays what happens in the workplace. The case is designed to be used in a variety of accounting settings: as a concluding experience in financial or managerial accounting, as a component of the inventory coverage in intermediate accounting, or in an accounting ethics class. If the case is used in the

financial or managerial accounting class, instructors may wish to provide students with copies or at least web links to the applicable GAAP and SEC guidance. The students who tested the case were provided with the applicable pages of Article 5 of Regulation S-X (SEC 1999), access to the inventory and cost of sales chapter of *Montgomery's Auditing Twelfth Edition* (as available through the University's subscription to PwCComperio), and FASB ASC 330 inventory. Students in upper-level courses should be able to conduct the appropriate research on their own, using databases available at their institutions.

Evidence of Learning Efficacy

The case has been used by two instructors in a total of five courses: (1) an undergraduate financial accounting class (62 students), (2) an undergraduate managerial accounting class (30 students), (3) an intermediate accounting I class (20 students), an MBA survey of accounting class (12 students), and an MBA class focused on accounting standard setting (5 students). It has also been successfully used in a one hour continuing professional education program attended by approximately 40 accounting professionals². In the managerial and MBA standard-setting courses, the case was assigned for the last class meeting of the semester. In the managerial accounting class students had the option of submitting their answers to the questions for additional points and all class members participated in the class discussion. The MBA students submitted their notes on the case and discussed the case.

In the financial accounting class the case assignment represented 20% of the students' overall grade. Grading was primarily based on the quality of the written responses to the case questions but there was a component which included points based on the quality of their class participation. In the intermediate accounting and MBA survey classes the case was assigned

² An earlier version of the case was used in the principles and MBA classes, as well as in the CPE presentation. That case differs from the current version only in its lack of detailed reclassification entries and Figure 1.

following the coverage of inventory accounting. Students prepared a no-longer than 2 page single-spaced memo and also participated in a class discussion. Thus, students had significant incentive to engage in the case study.

In all classes the discussions were very lively, with students divided as to whether or not the reclassifications were in accordance with GAAP. There was also strong debate as to whether or not the reclassifications violated appropriate ethical practices.

To assess students' perceptions of the case, a survey was distributed to the students in the financial and managerial principles, the MBA survey, and the intermediate classes following the case discussion. The survey questions address students' perceptions of how specific case content changed their understanding of business and financial reporting, whether or not the reclassifications are in accordance with GAAP, whether or not the reclassifications are in accordance with ethical principles, of the case's learning value, and overall student perceptions. We tabulate the results of the three classes in which formal memos were required: the responses of 62 financial accounting students, 9 MBA students and 20 intermediate accounting students. As indicated above, these students had a strong incentive to carefully read and evaluate the case.

Table 2 Panel A presents the student responses to questions of the impact of the case on student understanding. The results indicate that students at all three class levels believe the case positively impacted their understanding that: budgetary pressures may impact accounting decisions; it may be possible to rationally classify expenses in different accounts; Wall Street analysts evaluate a company's performance on more than just ROI, profitability and revenue growth; full and fair financial reporting includes adequate disclosure of changes in the way revenues and expenses are included in the financial statements; and accounting guidance may not

always provide all the answers to accounting questions. The mean responses range from 3.56 to 4.67, the median values are 4 or 5, and results of the one-tailed t-tests of difference from the mean value of 3 cluster around the .000 to .009 range, with only one value greater than .009.³

Consistent with the case design and intent, students were very mixed in their responses to questions that asked if the reclassifications violated GAAP, about the propriety of Rebecca's request, the accounting department's approval of the reclassifications, the ethical nature of the reclassifications, and whether or not David would act the same with more education or more experience. As shown in Table 2 Panel B, most students believed that the reclassification did not violate GAAP; the intermediate students were strongest in this response. The MBA and intermediate students were more likely to believe the reclassifications were ethical and were the least troubled with the three reclassifications.

Overall, (as shown on Table 2 Panel C) the students reported that the case increased their understanding of the complexities of financial reporting (means = 4.05 to 4.22), the extent to which they thought about ethical considerations surrounding financial reporting (means = 4.05 to 4.37), and the extent to which they found the case a valuable learning experience (means = 4.22 to 4.50).⁴

The financial accounting students provided the following responses to open-ended questions. When asked what they considered to be the best parts of the case, they responded with: "easy to understand, not too technical;" "no right or wrong answer;" "really shows how vague situations can be;" "makes you see accounting in a different light;" "David's relationship with the accounting team;" "the [facts] are hard to interpret so it really made me think about my

³ Responses to the questions in this set are based on a five point scale where 1 = [had] "no impact on my understanding" and 5 = "significantly increased my understanding".

⁴ Responses to the first two questions in this set are based on a five point scale where 1 = [had] "no impact on my understanding" and 5 = "significantly increased my understanding". The final question is based on a five-point scale where "1" = no and "5" = "yes".

personal views;” and “the evaluation of a real world situation.” When asked if they recommend the case be used again, 61 out of 62 students responded yes. They thought the case was a good example of a real life scenario, it was helpful toward applying accounting concepts, the content was very controversial, it covered a lot of information, it led to a great discussion that made everyone think, and it provided a good example of what can happen to a new employee in the workforce. Similar comments appear in the other classes assessment forms.

One management accounting student provided the following summarized comments in an email exchange with the professor:

I just found the story really interesting. . . I thought that I could easily find myself in David's position one day. . . I think [the case] was the perfect connection to [financial accounting]. After reading the story I knew exactly what I wanted to say about it, and it so happened that the questions you asked us to answer were the same questions I was prepared to answer. I wish you had assigned more [cases] similar to this one, however I realize that scenarios such as David's probably aren't very easy to come up with.

Participants in the CPE session actively discussed the case for over an hour. They liked the fact that David went back three times for more expense reclassification. They believed the logic underlying the first reclassification was pretty clear, the basis for the second reclassification was grayer, and by the third time it was very gray and may have crossed an ethical line. They believe having multiple reclassifications shows how events can escalate and grow. The audience felt the case was a very realistic portrayal of what accountants face in the workplace. They commented on how the case focus was very much in the gray area, rather than a black and white issue, so it took a lot of thought to determine what the appropriate answers should be.

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