

Ethical Issues; Underapplication of Manufacturing Overhead

Marc Jackson has recently been hired as a cost accountant by Offset Press Company, a privately held company that produces a line of offset printing presses and lithograph machines. During his first few months on the job, Jackson discovered that Offset has been underapplying factory overhead to the Work-in-Process Inventory account, while overstating expenses through the General and Administrative Expense account. This practice has been going on since the start of the company, which is in its sixth year of operation. The effect in each year has been favorable, having a material impact on the company's tax position. No internal audit function exists at Offset, and the external auditors have not yet discovered the underapplied factory overhead.

Prior to the sixth-year audit, Jackson had pointed out the practice and its effect to Mary Brown, the corporate controller, and had asked her to let him make the necessary adjustments. Brown directed him not to make the adjustments, but to wait until the external auditors had completed their work and see what they uncovered.

The sixth-year audit has now been completed, and the external auditors have once again failed to discover the underapplication of factory overhead. Jackson again asked Brown if he could make the required adjustments and was again told not to make them. Jackson, however, believes that the adjustments should be made and that the external auditors should be informed of the situation.

Since there are no established policies at Offset Press Company for resolving ethical conflicts, Jackson is considering one of the following three alternative courses of action:

- Follow Brown's directive and do nothing further.
- Attempt to convince Brown to make the proper adjustments and to advise the external auditors of her actions.
- Tell the Audit Committee of the Board of Directors about the problem and give them the appropriate accounting data.

Required:

1. For each of the three alternative courses of action that Jackson is considering, explain whether or not the action is appropriate.
2. Independent of your answer to requirement (1), assume that Jackson again approaches Brown to make the necessary adjustments and is unsuccessful. Describe the steps that Jackson should take in proceeding to resolve this situation.