

A Reporting Dilemma: Hiring Freeze Headcount

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INTRODUCTION

The Semiconductor and the Two-Way Radio divisions are two major divisions in Big Electronics Company International (BECI). These two divisions each have multibillion-dollar sales. Manufacturing, direct distribution, and sales occur primarily in the United States, Western Europe, Canada, and Australia with feeder and assembly plants located throughout Southeast Asia and Latin America.¹ Service for the developing world happens through distributors and commission agents, while export support activity takes place at BECI's headquarters in Dallas, TX. The Semiconductor division has six established production facilities in Southeast Asia and Mexico, but the Two-Way Radio division is opening its first production facility in the developing world in Penang, Malaysia. The two divisions are managed and operated separately.

In March 2013, the Two-Way Radio division opened its first overseas production facility in a free trade zone in Penang, Malaysia. Figure 1 shows reporting relationships for the Penang production facility. Figure 2 shows a partial BECI organizational chart reflecting how the Penang facility fits into the overall company. Figure 3 presents the timeline for events relative to this case. Because the facility plans to make semiconductor components exclusively for two-way radio products, the operation is part of the Two-Way Radio division and not part of the Semiconductor division.

Two years prior to the opening of the Penang facility, BECI hired 26-year-old Sam as a supervisor of financial analysts for a domestic group in another large division. Based on Sam's well-regarded job performance in that position, BECI promoted him to financial controller of the startup Penang operation. Sam has a wife and two young children. To start up the operation, Sam moved to Penang along with two others: Dave the general manager and ceramic engineer, and Glenn the engineering manager and mechanical engineer. Sam, Dave, and Glenn are all in their late 20s. The operation is expected to eventually be a considerable contributor to BECI's profitability because of the low labor cost and favorable tax treatment. Management at the Penang Production Facility plans to hire as many as 3,000 employees in the next five years and, if all goes well, 10,000 within the next 10 years. The Penang operation reports to Max, a vice president and operations manager at the headquarters of the Two-Way Radio division in Miami, FL. He in turn reports to the chief executive officer (CEO) at corporate headquarters in Dallas. Max is viewed as a man of integrity and a superstar of the present and future. He is well respected for his business expertise and highly regarded by all.

The Penang plant started shipping semiconductor components and products to the Two-Way Radio division in Miami in May 2013. By September, the operation had hired 400 employees and was already considered very successful. Sam has 10 employees in the Accounting department, which will likely increase in the future as the division has plans

¹ Big Electronics Company International has approximately 70,000 employees and is listed on the New York Stock Exchange.

to increase the total operation's employment to as many as 3,000 within the next two years.

Sam and his staff have designed and implemented accounting policies and procedures consistent with BECI policies. As controller, Sam is responsible for all reporting to the United States, including all monthly financial reports and monthly headcount reports. All reporting is made directly to division headquarters in Miami, which consolidates division reporting and eventually sends it to Dallas to be included in consolidated BECI reporting. Costs (including fringe benefits) per head for clerks and factory workers in Penang are approximately 10% of U.S. personnel costs. Total cost of the operation in relation to productivity is low. It is regarded as a successful and efficient operation. The three young expatriate managers are viewed favorably within BECI.

THE WORLD ECONOMY

The global economy was in recession early in 2013. Consolidated BECI sales and profits were rapidly plummeting. In September 2013, the chairman of the board and the CEO initiated a global hiring freeze and were putting pressure on all operations to maintain or reduce headcount. U.S. operations were laying off employees, while the Penang operation was hiring. Dave (Sam's boss in Malaysia) and Max (Dave's boss in Miami) were under pressure not to hire. Max went to the chairman of the board and CEO and laid out his case:

"Hiring additional personnel and increasing production in Penang, Malaysia, would reduce net company costs and, thus, would increase the Miami Two-Way Radio division's and overall BECI's profitability. Hiring additional personnel would result in further BECI cost savings."

The argument fell on deaf ears, though. The chairman of the board and CEO tell Max: "We have bigger problems. Go solve your own problems. We do not want to hear any more about hiring in Penang."

The hiring freeze for BECI remained in place through 2014, and reports were reviewed at a consolidated level for any changes in headcount. BECI is a nonunionized company that prides itself on treating employees well. Though, from a cost-benefit point of view, laying off employees worldwide and hiring in Penang would be economically beneficial; from political and employee relations points of view, it would create difficulties.

A REPORTING DILEMMA

Max has a dilemma. If the Penang operation does not continue to hire, the Miami division as well as BECI will not reap potential benefits of the Malaysian facility. Yet, additional hiring in Penang would violate the worldwide BECI hiring freeze. One possible, but not explicit interpretation of the words from the chairman of the board and CEO is that Max should do what he thinks best but not tell them. Max's resolution of the dilemma is to tell Sam to divide total Malaysian payroll plus benefits by the average cost of an employee in the United States, not Malaysia, which is much lower, and use that number to report Malaysian headcount, which is then consolidated into the division's headcount. Thus, instead of reporting 400 new employees, 40 employees would be reported, and the Penang operation would continue hiring. Dave (Sam's immediate boss) also encourages following Max's request. The Finance department employees in Miami, to whom Sam sends all Penang operation reports, also encourage reporting as Max requests. These employees also ultimately report to Max. The Two-Way Radio division employs approximately 30,000 people.

Without additional headcount, it would be difficult for the Malaysian operation to continue being so successful. Sam realizes that hiring additional employees will allow him to continue to perform well in the eyes of his superiors and will result in a more positive contribution to profitability to BECI in total. All financial reports would be accurate; only the headcount would be understated. That number gets aggregated with other operations and is ultimately rounded to the nearest thousand at the division and corporate levels. Because of this rounding, the public reports to the U.S. Securities & Exchange Commission (SEC) will most likely not be misstated at all, or if they are, it will not be a material amount. Sam, Max, and all other parties know that financial reporting must be accurate. Sam is only asked to show "creativity" on the headcount report.

Sam views BECI as having an overall high integrity environment. This is the only request that he has ever received to not report accurately. Internal auditors will visit the location in its second year but focuses on internal controls primarily as incorporated in BECI's financial and operating policies and procedures. Sam and the Penang Accounting department carefully follow these policies and procedures. Thus, there is minimal expectation that the headcount reporting would be an issue.

² IMA® *Statement of Ethical Professional Practice*, Institute of Management Accountants, Montvale, N.J., July 2017.

³ AICPA Code of Professional Conduct, American Institute of Certified Public Accountants, December 2014, www.aicpa.org/research/standards/codeofconduct.html.

CASE QUESTIONS

Help Sam determine the appropriate course of action.

There are many approaches to ethical decision-making.

The IMA® (*Institute of Management Accountants*) *Statement of Ethical Professional Practice* recommends following your organization's established policies for resolving ethical issues.²

If the organization does not have established policies, the IMA Statement first recommends discussing an ethical issue with your immediate supervisor. If the supervisor appears to be involved, present the issue to the next higher level of management who does not appear to be involved. The highest level would be the Audit Committee of the Board of Directors. If this does not bring resolution, the next consideration could be IMA's anonymous hotline. Another possible step would be consulting your attorney.

The AICPA (American Institute of Certified Public Accountants) Code of Professional Conduct³ similarly recommends that if you find yourself in an ethical conflict, first consider relevant facts and circumstances, including applicable rules, laws, or regulations; second identify the ethical issues involved; and third consider established internal procedures.

Questions 1 through 6 ask what course of action Sam would take if he were guided by utilitarianism, deontology (Kant's categorical imperative), virtue ethics, giving voice to values, behavioral ethics, or professional ethical principles. Question 7 asks for your recommendation to Sam.

1. The utilitarian approach to ethical decision-making entails identifying potential alternative courses of action and selecting the alternative that maximizes net utility. Utility is defined as whatever produces pleasure or happiness and whatever prevents pain or suffering. This principle can be used by individuals as well as by legislators in drafting laws. There are two major objections to Utilitarianism. The first objection is that it fails to respect individual rights. By caring only about the sum, it does not consider the treatment of individuals. Ultimately, utilitarianism could sanction ways of treating persons that violate fundamental norms of decency. Minorities could be discriminated against to benefit the majority. The second objection is that utilitarianism counts everyone's preferences equally. Under this approach, it is necessary to measure, aggregate, and calculate happiness on a single scale. Some people question whether it is possible to translate all moral goods into a single currency of value without losing something in the translation. Cost benefit analyses can be used

as a tool in applying utilitarianism. Any cost-benefit analysis should consider costs and benefits internal to the company as well as external costs and benefits. Even considering its flaws, utilitarianism is an influential approach to making moral decisions. All stakeholders should be considered, including but not necessarily limited to BECI shareholders, current U.S. and Malaysian BECI employees, future BECI employees, citizens of the United States and of Malaysia. Which course of action would a utilitarian select?

2. Deontology is an ethical theory that focuses on rules that embody our moral duties. Kant advocates treating all humans with dignity and respect. To act ethically is to perform one's duty by following the categorical imperative. One formulation of the categorical imperative is to act in such a way that you always treat humanity, whether in your own person or in the person of any other, never simply as a means but also as an end. Another formulation of the categorical imperative is to act only on principles that we could universalize without contradiction. In any alternative course of action considered by Sam, is anyone or any group being used solely as an end to benefit the ends of others? What course of action would be consistent with the categorical imperative?
3. A virtue ethics approach to ethical decision-making requires identifying the civic and business virtues expected of executives and then selecting the alternative course of action that best reflects those desired virtues. Aristotle believed that when determining which virtues should be rewarded, one should consider the purpose of the social or, in this case, business practice in question. Aristotle's view of the moral life was living a life of virtue, which is the "good life." Virtues are character traits that go deep down inside of people. Desirable virtues are determined by deliberation within the community. What is the purpose of the controller, and what virtues should be honored? After deliberation and agreement within the professional communities, desirable virtues have been recommended in the *IMA Statement* and the AICPA Code of Professional Conduct. IMA recognizes competence, confidentiality, integrity, and credibility as values to which accounting professionals are responsible to adhere. The Principles section of the AICPA Code of Professional Conduct expresses tenets of ethical and professional conduct. These responsibilities include cooperation within the profession, acting in the public interest, maintaining integrity, discharging services objectively

free of conflicts of interest, maintaining independence for attest clients, striving to continually improve competence and quality of service, and discharging responsibility to the best of your ability. Additional sources of virtues might be one's social and spiritual communities. What are desirable virtues to guide Sam's decision? What course of action is consistent with these virtues?

4. Question 3 discussed identifying appropriate values to guide decisions. Yet many of us, including Sam, may encounter conflicting values, such as loyalty vs. integrity or self-interest vs. professional responsibility. Sometimes the way we want to live and the things we want to accomplish seem in conflict with expectations of our bosses, our clients, our peers, or our organization. This case demonstrates that it can be challenging to effectively stand up for your values when pressured by your boss (or in other cases colleagues, customers, or shareholders) to do the opposite. Despite internal and external pressure, some people effectively voice and act on their values. Consider your personal values. Are these values consistent with and perhaps influenced by IMA and AICPA as discussed previously? Are your values aligned with Max's and Dave's? Do your values align with following BECI's policy of maintaining a worldwide hiring freeze? How might you voice your values in this situation? If your values are not consistent with your boss's values, how can you effectively communicate your concerns? Would confrontation, reasoned discussion, or some other approach be more effective?
5. Behavioral ethics is a descriptive, as opposed to a normative, approach to ethical decision-making. This approach addresses how people actually make ethical decisions as opposed to how philosophers say they should make decisions. Desires and self-interest powerfully influence the way one interprets information. When motivated to reach a particular position, a person usually does. Psychologists conclude that overcoming unconscious biases is challenging, resulting in faulty moral reasoning that further social agendas, to justify actions. What action might innate biases lead Sam to select? How might Sam overcome these biases and make an ethical decision?

6. As discussed previously, the *IMA Statement* indicates that ethical principles include honesty, fairness, objectivity, and responsibility. As a CMA® (Certified Management Accountant), what are Sam's professional responsibilities related to the headcount reporting dilemma? Likewise, the AICPA principles include exercise of sound moral judgment, acting in the public interest, integrity, objectivity, and due care. What are possible courses of action that Sam could take? Considering the *IMA Statement* and the AICPA Code of Professional Conduct, which action should Sam take?
7. What action would you take if you were in Sam's situation?

ABOUT IMA® (INSTITUTE OF MANAGEMENT ACCOUNTANTS)

IMA®, the association of accountants and financial professionals in business, is one of the largest and most respected associations focused exclusively on advancing the management accounting profession. Globally, IMA supports the profession through research, the CMA® (Certified Management Accountant) program, continuing education, networking and advocacy of the highest ethical business practices. IMA has a global network of more than 100,000 members in 140 countries and 300 professional and student chapters. Headquartered in Montvale, N.J., USA, IMA provides localized services through its four global regions: The Americas, Asia/Pacific, Europe, and Middle East/India. For more information about IMA, please visit www.imanet.org.

Figure 1. Big Electronics Company International Penang Management Team

CEO and Chairman of the Board, BECI Corporate Headquarters, Dallas, TX

Max – Vice President and Operations Manager, Two-Way Radio division in Miami, FL; reports to the CEO in Dallas, TX

Dave – General Manager, Two-Way Radio Production Facility in Penang, Malaysia; reports to Max in Miami, FL

Sam – Controller, Two-Way Radio Production Facility in Penang, Malaysia; reports to Dave in Penang, Malaysia

Glenn – Engineering Manager, Two-Way Radio Production Facility in Penang, Malaysia; reports to Dave in Penang, Malaysia

Figure 2. BECI Partial Organization Chart

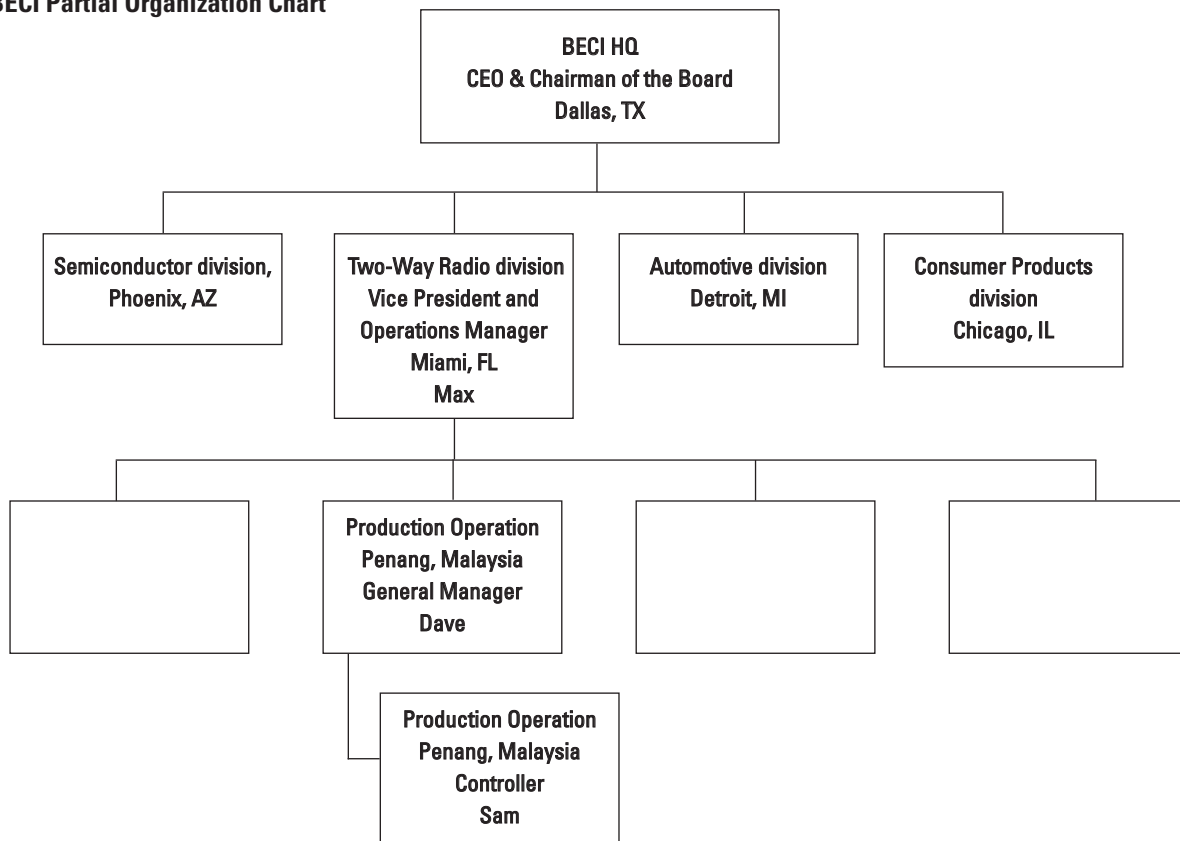


Figure 3. Timeline

January 2011	Sam is hired by BECI to be a supervisor of financial analysis within the Two-Way Radio division.
October 2012	Dave is appointed general manager and Glenn is appointed mechanical engineer for the future Penang Production Operation.
January 2013	Sam is appointed controller of Penang Production Operation.
March 2013	Sam, Dave, Glenn, and families move and start up Penang Operation.
May 2013	Penang Operation begins shipping small quantities of hybrid circuits (components) to Miami, FL.
September 2013	BECI announces a global hiring freeze as thousands of employees are laid off.
October 2013	Max requests Sam to report headcount based on Malaysian payroll divided by U.S. average salary, not actual headcount.