Apel Manufacturing?
Teaching Notes

What Are the Relevant Facts?

1. Apel Manufacturing's real estate is leased from its major shareholders and reported as an operating lease.
2. A review of Statement of Financial Accounting No. 13 reveals that the lease terms coupled with the related-party transaction indicate that capital lease treatment is appropriate.
3. Jon, the controller, believes the lease is a capital lease. Therefore, a capital lease obligation should be reflected on the financial statement.
4. (Students may need to review Statement of Accounting Standards No. 13, paragraphs 5(a), 7, and 29, which discuss lease arrangements between related parties.)
5. The CEO, Rex, does not want a lease liability on the balance sheet. He fears the resulting increase in liabilities may hamper the company's chance for a loan needed to modernize and stay competitive.

What Are the Ethical Issues?
Is Jon's professional obligation to follow generally accepted accounting principles greater than the need for the company to obtain needed financing for essential improvements and expansion?
What is Jon's obligation to Apel and its shareholders and employees versus his obligation to parties using the financial statements for investment or credit decisions?

Who Are the Primary Stakeholders?

- Jon, the recently employed controller
- Rex, the CEO
- Apel's shareholders
- Existing employees and potential employees of Apel if the renovation is completed as planned
- Creditors

What Are the Possible Alternatives?

Jon can:

1. Report the lease as an operating lease as Rex directs.
2. The potential creditors will have to ask pertinent questions to find out about the lease arrangement with the major shareholders.
3. Insist the lease be capitalized and live with the consequences.
4. Report the lease as an operating lease but work to convince the auditors to pressure management to capitalize the lease.

What Are the Ethics of the Alternatives?

- Based on a utilitarian costs and benefits analysis, for each alternative:
  1. What are the benefits and costs to each stakeholder?
  2. Do aggregate benefits exceed the costs to all stakeholders?
- Based on a "rights" perspective, for each alternative:
  1. What are the rights of each stakeholder?
  2. What is Jon's responsibility to Apel?
  3. What are Apel's responsibilities to Jon, the other employees, and creditors?
- Considering a "justice" point of view, for each alternative:
  1. What are each stakeholder's burdens and benefits?
  2. Does one alternative most fairly distribute the burdens and benefits?

What Are the Practical Constraints?

1. If the creditor requires audited financial statements, the failure to record a capital lease may result in a qualified audit opinion.

What Actions Should Be Taken?

1. What action would you take if you were Jon?
2. Why did you choose this alternative?
3. What ethical theories helped you with your conclusion?