

BTN 10-3 Flo Choi owns a small business and manages its accounting. Her company just finished a year in which a large amount of borrowed funds was invested in a new building addition as well as in equipment and fixture additions. Choi's banker requires her to submit semiannual financial statements so he can monitor the financial health of her business. He has warned her that if profit margins erode, he might raise the interest rate on the borrowed funds to reflect the increased loan risk from the bank's point of view. Choi knows profit margin is likely to decline this year. As she prepares year-end adjusting entries, she decides to apply the following depreciation rule: All asset additions are considered to be in use on the first day of the following month. (The previous rule assumed assets are in use on the first day of the month nearest to the purchase date.)

Required

1. Identify decisions that managers like Choi must make in applying depreciation methods.
2. Is Choi's rule an ethical violation, or is it a legitimate decision in computing depreciation?
3. How will Choi's new depreciation rule affect the profit margin of her business?

ETHICS CHALLENGE

C1

