Case 16-5 - HANDOUT
Skeptical Lens

Case Study A – Not just a trivial item

Worrying that I was being a bit of a pest, at Susan's suggestion, I went to Mike, the engagement partner, showed him what I'd found, and asked if there was something I was missing.

He took a look and – to make a long story short – after consulting with our Fraud Risk Center, called a meeting with the chairman of the Audit Committee. Over very strong objections from the CFO, an independent investigation commenced.

Ultimately, to my amazement, what slowly emerged were the outlines of a multi-million dollar embezzlement scheme that had been perpetrated over a period of time by the CFO, the clerk I'd initially talked to, and another person in company management.

It was this experience that rooted in me a healthy respect for the many seemingly mundane details of an audit. Tests of details are at the heart of a quality audit and that is why it's vital that they are performed—and documented—properly.

Naturally, there was a lot of upheaval, but ultimately we earned a deep sense of trust and confidence from the Audit Committee.

By sticking to the facts and remaining undeterred by a tough client, we served the interests of the Audit Committee and the shareholders of the company, just as we were supposed to do.

Case Study B – Journal entries reveal a puzzling pattern

We inspected all of the controller's entries, and concluded that there was, indeed, no material impact to the year-end financial statements. We deliberated as a team, and considering that we were not reporting on internal control over financial reporting, we contemplated the appropriate response on our part.

The CEO implored us to let the issue go. 'Why make something of nothing? If our year-end financials are fairly stated—and they are—then your responsibility ends there, surely?' he said.

After discussion with the EQCR, undergoing a national office audit consultation, and discussion with the Office of General Counsel, we formulated our response. Our partner explained our position to the client. 'As auditors, we believe we have a responsibility to explain our findings to company ownership — as we think your control process has been compromised,' he said.

The advice we received from the EQCR and national office audit consultations group was pragmatic: To modify our procedures to consider any other potential impacts to the financial statements and the controls. Through this detailed process we determined there were no other issues apart from the control irregularities noted. However, we still insisted on meeting with the leadership of the foreign parent company to explain our findings.

The parent company was disappointed with the U.S. management—they saw it as a violation of trust. The involved individuals were reprimanded, and changes were made to the authorization levels related to journal entries and the company ethics program and related training. The parent company was appreciative of our efforts. The local leadership team appeared to believe that the Firm had gone well beyond its responsibilities with the parent company, and our relationship with them was strained for quite some time. However, it has since improved after management realized that we acted responsibly with the appropriate level of skepticism and transparency.

It was not at all an easy experience, but in the end we had made the correct choices.

Case Study C – You just don't understand journal entries

After I'd explained the situation, the partner talked things over with the client's CFO, who promptly agreed to have his team perform a deep dive on the journal entries in question. 'If there are mistakes, they need to own them,' the CFO said.

Eventually, the entity unearthed a slew of errors in the underlying entries, accompanied by an array of mistakes in the supporting documentation.

Ultimately, as a result of these errors, we concluded that there was a 'material weakness' in the entity's internal control over financial reporting. And, while the errors didn't impact the amounts in the consolidated financial statements, it did result in several restatements at the subsidiary level. The client remediated the material weakness by making enhancements to their control structure and processes related to these transactions.

This was a valuable lesson for me at a key point early on in my career. When variances don't seem right and explanations aren't satisfactory, it's important to keep on digging, despite pressures to back off. The fact is that things did not make sense because they were wrong!

I also realized we should not be afraid or intimidated if we have to challenge the client personnel – it is not pleasant, but often necessary and it is part of our obligation as the independent auditor to the capital markets.