

Conflicting Clients

Topic: Auditing (Confidentiality , Misrepresentation of Fact)

Characters: Jennifer Grace, First-year member of her CPA firm's management group
Tom Ward, CFO of Fantastic Developments, Inc., a client

While reviewing the current-year audit working papers of Coshocton National Bank (CNB), the engagement manager, Jennifer Grace, noted something curious. In the working papers related to loan valuation, Jennifer saw that the commercial loan of Fantastic Developments had been randomly selected for confirmation but that Fantastic had not responded to either the initial or second confirmation request. The audit staff disposed of this "loose end" by alternate procedures: examining cash collections (which had become somewhat sporadic) and vouching to underlying loan documentation, including a set of recent (unaudited) financial statements that showed Fantastic's solid financial position and operating profitability.

Jennifer noted this reference to Fantastic Developments because this private company was also a client of her firm. In fact, Jennifer had served as the audit senior on the prior-year audit of Fantastic. She knew that the company had been struggling for a couple of years and had experienced recurring operating losses. Her knowledge of Fantastic did not reconcile with the discussion in the audit working papers related to the financial statements furnished to the bank.

When Jennifer contacted Fantastic's CFO, Tom Ward, and inquired about the company's apparently miraculous turnaround, he was noncommittal and unhelpful. Tom replied that business had picked up. He apologized for not calling Jennifer's firm himself because he had been so busy, and then he told her that Fantastic had decided to engage another CPA firm for its accounting and auditing needs. Although confused, Jennifer obviously couldn't reject the possibility that this abrupt dismissal was a direct consequence of her inquiry.

As a result, Jennifer wonders whether the financial statements which Fantastic furnished to the bank as a basis for a loan application are fraudulent. The bank apparently has no such suspicion, however.

Author: Donald E. Tidrick, Assistant Professor of Accounting, University of Texas at Austin.