

# Cbi case solution

Business



CBI Holding Company, Inc. Case Solution I. Summary A CBI Holding Company was a New-York based parent company for several wholly-owned subsidiaries. These marketed an extensive line of pharmaceutical products that were purchased from drug manufactures, warehoused in storage facilities and then resold to retail pharmacies, hospitals long-term care facilities and related entities. CBI's chairman and president Robert Castello was the seat of the CBI's troubles and principal implementer of fraudulent schemes.

When in 1991 he sold 48 % ownership to TWC, both companies agreed that TWC would have the right to take control of CBI in case of any so-called triggering events. Shortly after this deal in following 1992 and 1993 Castello and his subordinates were intentionally misrepresenting operating results and financial conditional for the end of fiscal years mainly for enlarging Castello bonuses. To be more specific CBI understated payables at the end of fiscal 1992 and 1993 due to its large vendors by millions of dollars particularly by developing the " advances" ruse. These fraudulent activities were thoroughly concealed from TCW's appointees to the board and it's management and CBI auditor- Ernst ; Young that from 1990 till 1993 issued unqualified opinions. After the fraud was disclosed E; Y withdrew its 1992 and 1993 unqualified opinions. But in this case E; Y was held responsible for CBI's bankruptcy.

Even though it classified CBI's engagement like close monitoring due to its higher than normal audit risk and identified accounts payable as a high risk audit area it failed to exercise due care, obtain independence and comply with GAAS. As a result of that Judge Lifland characterized E; Y CBI's audit as

grossly negligent that caused substantial material losses to TWC's party and CBI's vendors. II. Questions 1) To my point of view an auditor's primary objective in auditing accounts payable is to identify whether accounts payable are represented fairly and accurate and so to consider inherent risk including fraud risk, internal controls over receivables and revenue and ascertain the existence of receivables and the occurrence of revenue transactions. Thus auditor should assess control risk and perform test of controls and substantive test of transactions. In a CBI's case auditors failed to reconcile vendor's statements with recorded liabilities and the accounts payable with the general ledger and that was their biggest mistake.

But if E; Y had properly reconciled the balances and managed to maintain adequate vendor year-end statement's sample and if they had paid more attention to the facts that proved the CBI's control environment being ineffective they would not fail to recognize the fraud. This is obvious because if only auditors looked at any major vendor's invoice amounts for purchases they certainly would have discovered huge discrepancies. ) Yes, I do believe that confirmation should be used in auditing CBI's year-end accounts payable. Firstly because it's more reliable source than ordinary vendor statements as they are held in the hands of the client when auditor examines it. Secondly, CBI's internal controls are completely deficient and accounts payable are identified as high risk audit area.

In CBI engagement auditors should have send confirmations to several largest vendors with emphasis on CBI's of liabilities that should be confirmed by them. Confirmation for both accounts payable and receivable are of the same general nature. But in case of confirmation accounts receivables it's a <https://assignbuster.com/cbi-case-solution/>

requirement from Auditing Standards (SAS 67 AU 330) and when you decide not to confirm you should make a justification for this. Moreover, it's the only way of checking the existence, accuracy and cutoff objectives. In contrast, confirmation of accounts payable is not a requirement and we can use other alternatives like vendors statements to check it.

) Personally I support a position that auditor should have a responsibility to inform client management of mistakes or oversights made on earlier audits and especially in case where there is a big probability that such mistakes will be repeated. That will allow management to improve internal controls in bottlenecks and prevent this happening next time. 4) I suppose that an engagement partner could acquiesce to a client's request to remove of the engagement team under circumstances for example when engagement team would be suspected in failing to maintain independence or when management would find out that engagement team demonstrates lack of expertise while conducting the audit. 5) The auditor exercises professional judgment when making the decision to accept a new client or to continue serving an existing client. To aid in making the judgment, auditing firms apply prescribed procedures to the potential client. Of the procedures, perhaps the most important deals with the integrity of management.

The auditor's business risk associated with a management that lacks integrity is difficult to overcome. Despite auditor's business risk being high, an acceptable engagement risk may still be achieved. Audit risk can be adjusted such that the combination of entity's business risk, audit risk, and auditor's business risk yields an engagement risk that is sufficiently low.

However, if management lacks integrity, adjusting the nature, timing, and

extent of audit procedures performed on management assertions may not produce an acceptably low audit risk. In making a decision to continue a client, the auditor should carefully consider previous experiences with the entity as well as changes the client has recently experienced.

Besides changes in the client, the auditor also considers client acceptance decision. The presence of an unsatisfactory result for any one, or even a few procedures, does not automatically imply the client is unacceptable. Rather, negative findings serve to heighten the auditor's skepticism and increase the assessment of auditor's business risk and thus engagement risk. If engagement risk is assessed at an unacceptably high level, the auditor does not accept a new client or continue serving an existing client. This policy helps to maintain an appropriate mix of clients for the auditor.