

A crisis of confidences

Sociology



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Mr. Kenneth Lay held a great deal of responsibility because he spearheaded the overstatement of Enron's income for four years prior to the bankruptcy. This effectively and efficiently led to his conviction for securities fraud, wire fraud and making false and misleading statements. Thirdly, Mr. David Duncan held some of the responsibility because he was aware that there were violations with regards to the rules of bookkeeping and was bounded by the ethics of his profession to report such violations. By not doing this, he was responsible to some degree for the final collapse of Enron. Fourthly, the accounting firm of Arthur Andersen held the responsibility because they were hired as auditors to ensure that the accounting rules were being followed. At any point during the audit, they could have reported the misdoings of the Enron officials. Finally, the stock analysts held some blame because they continued to recommend Enron stocks even after the value of shares in the Enron Corporation fall drastically in late 2001.

2. List three types of consulting services that audit firms have provided to their audit clients in recent years. For each item, indicate the specific threats, if any, that the provision of the given service can pose for an audit firm's independence.

Three types of consulting services an audit firm has provided to an audit client in recent years are as follows:

Bookkeeping Services

Financial Information Systems Design and Implementation

Human resources consultation services

The potential compromise of independence in the provision of bookkeeping services of an audit client lies in the fact that there may be a conflict of interest. The conflict of interest is such that the audit firm will be called upon

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to audit its own consulting work. The provision of Financial Information Systems Design holds the potential for compromise of independence because of a conflict of interest. The conflict lays in the fact that the audit firm may work to develop a financial system that proves to be beneficial to itself and to the detriment of its client. Finally, the provision of human resources consultation services is a breach of independence because it puts the audit firm in a position where it can function as management or as an employee of the audit client. This effectively and efficiently precludes independence.

3. For purposes of this question, assume that the excerpts from the power report shown in exhibit 3 provide an accurate description of Andersen's involvement in Enron's accounting and financial reporting decisions. Give this assumption; do you believe that Andersen's involvement in that decision violated any professional auditing standard? If so, list those standards and briefly explain your rationale.

I feel that Andersen's involvement in Enron's accounting and financial reporting decisions violated any professional auditing standards. The standards they violated included:

SAS 82 whereby Andersen was duty-bounded to ensure that the management of Enron understood the risk of fraud and its ramifications. Moreover, the auditors were responsible for searching for fraud. In neglecting to do this, Andersen failed to protect the public interest.

In 1996, Waste Management's audit reports from Andersen proved to be false and misleading. The reports essentially inflated the income of Enron by over \$1 billion dollars between 1992 and 1996.

In 1997 Andersen was aware of the use of accounting tricks to create false

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sales and profits in the case of Sunbeam, an Enron subsidiary. Their knowledge of this was substantiated by the SEC finding that one of its auditors flagged it.

The GAAS guideline with regards to independence. As per the guidelines an audit company has to remain independent in both fact and appearance. Andersen failed to do this by having many of its employees work for either Enron or its subsidiaries.

Andersen violated the rules regarding the retention of audit work papers.

4. Briefly describe the key requirements included in professional auditing standard regarding the preparation and retention of audit work papers, which party owns audit work papers; the client or the audit firm

SAS 41 issued in 1982 reiterated the rule that auditors should have work papers and the work papers should follow the GAAS guidelines. The work papers are aimed at establishing the primary record of the work done as well as the conclusions reached. The audit company owns the work papers and they are meant to substantiate the auditors' report. They should document the following:

The work has been adequately planned and supervised;

Internal control has been appropriately studied and evaluated; and

The evidence obtained and procedures performed afford a reasonable basis for an opinion.