

Crazy eddie case essay



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The main critical issue in the Crazy Eddie case is the incompetence and lack of professional skepticism of the company's audit team and their inability to successfully comply with the standards of GAAS. The auditors failed to exercise the fundamentals of the substantive audit plan which would have uncovered at least some of the fraud. Furthermore, this inability and lack of knowledge on how to properly execute an audit threatened the independence of management and internal auditors as well as the outside auditing firm.

The first critical factor and a major component of GAAS is Rule 101 or “independence” of the auditor in all areas of the audit, which in the case of Crazy Eddie was fractured. Crazy Eddie's accountants were former members of the firm conducting the audit, impairing independence. This is known as “independence in fact,” therefore the opinions of the auditors were compromised (Louwers, 43). Many auditors do not want to believe that their client is capable of committing a crime, and here we have them being former members which will surely cause a crack in the aspect of professional skepticism.

They are going to be less likely to fully evaluate the evidence given (or in this case some requested documents were not even presented to auditors.). The second critical factor is the lack of proper and effective internal controls in the organization and the auditor's insufficient understanding of these controls under GAAS. A successful substantive audit plan includes a proper evaluation of internal controls but this audit plan was weak. When the auditor develops the audit plan they consider audit risk.

The auditing firm providing consulting services to Crazy Eddie designed a computerized inventory system. It reduces the control risk if and only if employees used this system properly. However, Crazy Eddie ordered them to use the old manual system they previously used at the company. To say more, the auditors found discrepancies in the company records; however, due to their lack of investigative skills they did not act on those suspicions. If there are effective internal controls there would be good, strong evidence, however, it was found out that some requested documents were allegedly “lost.

This should have been a red flag to auditors, and they did not properly inspect records and documents. If you have nothing to hide, you usually would not have a problem providing requested information. The PCAOB gives clear guidance and a list of management assertions that auditors must address during the audit. Due to weak internal controls in the organization that auditors failed to discover, Crazy Eddie’s management assertions of Existence/Occurrence, Valuation/Allocation and Presentation/Disclosure are misrepresented (Louwers, 12-13).

The job of auditors is to make sure all transactions are accurate and all material is presented correctly however, Crazy Eddie had been misrepresenting inventory and profits for years. Another very important part of a successful audit and a crucial standard under GAAS relates to the level of fieldwork an auditor must do. The auditors again did not successfully comply with this standard as well. Sam Antar stated during one of trials that the company used something called “obstruction by distraction” on the auditors.

The company did their very best to distract auditors from their fieldwork by engaging them in plenty of “small talk” (Antar, 48). The auditors submerged into conversation and away from their duties under GAAS. This further caused them to rush and complete the work to meet with audit deadlines which most likely made them overlook a lot of inconsistencies in the work environment and financial statements.

The third critical factor is the “Familiarity Threat. Even if the individual had little experience or training for a particular position, Crazy Eddie still always tried to employ family members at his company. Crazy Eddie was even warned that especially for the CFO position he should hire a strictly unrelated party but he instead hired his cousin. This abundance of “related party transactions” greatly impacted the issue of independence. A non-family member especially if serving as CFO of the company can have been a whistleblower and might have tried to put a stop to fraudulent activity within the company.

Sam Antar, after being caught even stated “The prospect of dumping huge amounts of stock at inflated prices on unsuspecting investors kept the family together to commit more crimes” (Antar, 23). There was some family drama and fighting going on throughout the years within the company but family sticks together. Furthermore, Crazy Eddie did not act in the best interest of his company by paying higher salaries to his family members for hardly any work when he could have been using this money to help improve the business as a whole.

His accounting employees, those responsible for maintaining strong audit internal controls from inside the company were some of the individuals involved in the fraudulent activities. The job of external auditors is to evaluate the “ objectivity and competence” of the internal auditors of a company which in this case was clearly weak (Louwers, 84). Therefore, this all leads back to the incompetence and lack of a substantive audit plan that may have caught all of these problems. In conclusion, Crazy Eddie was a planned fraud; the family raised the stock price, and sold the stock at an inflated price to get a profit.

In CNN money, “ Take one to know one”, Sam Antar who was the former CFO of Crazy Eddie identified the accounting fraud that had been used in the case, including receipt skimming, money laundering and the counting bogus inventory. He said “ The total dollars involved were puny and the scams simple compared with later baroque swindles like Enron, but for sheer cojones, Crazy Eddie remains unchallenged. ” After Enron happened, Sarbanes Oxley has set a lot of rules and regulations for auditors which target to those trying to commit fraud. According to Sam E. inexperienced and lazy auditors contributed to the success of the scam.

Now the AICPA has increased the educational requirement and experience needed in order to get a license. Higher educational requirements would encourage higher ethical discipline, however, scam and fraud will never stop, and they will always be. As an investor or financial statement user, we should always try to examine the work and understand the financial statements and all the footnotes and cross references available to the material and ask the right questions.

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