**Written Assignment**

University of the People

Yasunori Kuji

# Abstract

This paper focuses on an ethical dilemma facing the audit team of Jennifer's CPA firm. Jennifer suspects that the financial statements submitted by Fantastic Developments, Inc. may be fraudulent, but the bank has no such suspicion. Jennifer believes that Fantastic Developments may be deceiving the bank. This paper will discuss the possible actions that Jennifer might take and compare their consequences following the ethical decision-making scheme. It also explains the importance of ethical and legal behavior regarding the Auditing Standard by American Institute of Certified Public Accountants. This research identifies the ethically and legally appropriate choices for Jennifer's options.

## Case Overview

The story on the agenda is often ambiguous, so let's get it straight first. Jennifer is a CPA firm auditor with CNB and Fantastic Developments clients. Jennifer was responsible for Fantastic's audit in the previous year and is currently reviewing CNB's audit working papers. Fantastic Developments had submitted financial statements to CNB and applied for a loan, which is inconsistent with Jennifer's knowledge. Tom Ward, Fantastic's CFO, gives a vague answer to Jennifer's inquiry and informs her that they have decided to hire another CPA firm. Jennifer doubts that Fantastic Developments may be cheating the bank.  
 Fantastic Developments did not respond to questions from the audit staff but did not specify which organization this staff member is from. For this paper, I assume that the audit team of the CPA firm asked the question. I believe the materials used by the audit staff for the alternate procedures are the financial statements submitted by Fantastic Developments to CNB.  
  
Ethical Decision-Making  
 When making ethical decisions in situations such as the one on this agenda, it is important to follow certain steps: 1. identify the problem 2. review the facts 3. evaluate multiple actions 4. select and implement the action 5. evaluate the results and modify as necessary (Velasquez

et al., 2018). These steps will help ensure ongoing ethical decision-making. Steps 4 and beyond cannot be performed in this assignment, so steps 1 through 3 are performed.

1. Identify The Problem

The ethical issue Jennifer is facing is that the financial statements submitted by Fantastic Developments to the CNB may be fraudulent. Jennifer suspects that Fantastic Developments. may be cheating the bank. This issue is related to the fact that Jennifer was in charge of auditing Fantastic's prior year and that Fantastic's financial situation was deteriorating.  
  
2. Checking The Facts

Jennifer's opinion involves a great deal of speculation. It remains undetermined whether Fantastic Developments is cheating the bank. It is also unclear why Tom Ward decided to hire another CPA firm. Jennifer has no evidence yet. It is also speculative that CNB has no doubts about Fantastic's financial statements. The following is a list of the facts that are currently known.

* Fantastic Developments is taking out a loan from CNB.
* CNB has received Fantastic's financial statements, which show that Fantastic Developments is stable.
* Jennifer was in charge of Fantastic's previous year's audit, and Fantastic's financial situation had deteriorated.
* Fantastic Developments did not respond to questions from the CPA firm.
* Tom Ward, Fantastic's CFO, gave Jennifer vague answers.
* Tom Ward decided to hire another CPA firm.

The Audit Standards (AS) issued by the American Institute of Certified Public Accountants, as known as PCAOB, states that in assessing the materiality of any illegal activity of which the auditor becomes aware, both the quantitative and qualitative materiality of the activity must be considered (PCAOB, n/d). Based on the information above, it is not possible to determine whether Fantastic Development is defrauding the bank.  
  
3. Evaluate multiple actions

Consider the advantages and disadvantages of two separate actions that Jennifer could take.  
  
**If she files an accusation  
Advantages**

* It can increase the credibility of the CPA firm.
* Can prevent fraud at Fantastic Developments.
* Protect the interests of CNB.
* Protects professional ethics.

**Disadvantages**

* It may cause legal problems due to leakage of client information.
* Even if there are no criminal charges, Fantastic Developments may file a lawsuit against the CPA firm.
* It may damage the company's relationship with Fantastic Developments.
* She could lose her place in the industry if the accusations are inaccurate.

**If she does not file an accusation  
Advantages**:

* Maintain a relationship with Fantastic Developments.
* Avoid legal issues.

**Disadvantage**

* Allowing Fantastic Developments to continue its fraudulent activities.
* It cannot protect CNB's interests.
* The CPA firm's credibility may be damaged if Fantastic's fraud is discovered.
* It would be unprofessional and unethical behavior.

## Auditor's Professional Ethics

The Attestation Standards (AS) issued by the American Institute of Certified Public Accountants (PCAOB) states that auditors must exercise professional skepticism to exercise due care in their profession. Jennifer's skepticism is consistent with this standard and is justified by professional ethics. AS 2405 Illegal Acts By Clients states that if the auditor becomes aware of possible illegal acts, they should obtain sufficient other information to assess the nature of the conduct and its impact on the financial statements (PCAOB, 2024). Jennifer should conduct a more in-depth investigation to gather facts.  
Joseph J. Tapajana (2018) states that if a CPA suspects fraud by a client, the CPA should alert the client of the concern and try to correct the problem. However, Jennifer is not obligated to file charges under SOX or PCAOB standards; AS 2405 and Tapajana state that a CPA should consider whether to sever ties with the client if the client refuses to take appropriate action. The CPA must consider whether to sever its relationship with the client if the client refuses to take appropriate action. For example, suppose a CPA discovers an error in a document previously filed. In that case, the CPA must advise the client of the consequences of not correcting the error but is not required to notify the authority if the client chooses not to correct it (Tapajna, 2018). Thus, the PCAOB recognizes that it is generally not permitted to disclose confidential client information without the client's consent.

On the other hand, however, Tapajana (2018) also states that disclosure without consent may be appropriate where a violation of criminal law has occurred. In any event, Jennifer suspects misconduct by Fantastic Developments and must take action to resolve this issue. The first step is to gather additional information to determine the seriousness of the matter.  
  
Auditor's Responsibility

AS 2405 clearly outlines the auditor's responsibilities in these situations. In summary, it states that the auditor is not responsible for disclosing illegal activity to parties other than the client. Such disclosure would violate the auditor's ethical or legal duty of confidentiality. On the other hand, however, it also states that there may be an obligation to notify non-client parties if that fact would have a material effect on the financial statements. In particular, if the successor auditor has made inquiries in proper procedures, it is permissible to disclose the facts to the successor auditor (PCAOB, 2024). This would be a great hope for Jennifer.  
 While auditors are not obligated to file charges, they must perform a proper audit. AS 2405 requires auditors to obtain a written statement from management that no violation or potential violation of law or regulation exists in the financial statements (PCAOB, 2024). Jennifer must, at a minimum, fulfill this responsibility.  
  
Actions Jennifer should take

Because of the complexity of the conflict between the auditor's ethical and legal confidentiality obligations, AS 2405 suggests that the auditor consults with legal counsel before discussing illegal activity with parties outside the client (PCAOB, 2024). By gathering additional information and consulting with the CPA firm's legal counsel, Jennifer can take appropriate steps to determine the seriousness of the illegal activity. While we feel that ethically, she should file charges immediately, considering professional ethics, legal responsibility, and ethical liability, the best option is to gather additional information and consult with legal counsel, as we have discussed. Having suspicions about Fantastic development is important, but legal issues must be exercised with caution to avoid them.

# Conclusion

This paper has focused on an ethical dilemma facing the audit team at Jennifer's CPA firm. Following the ethical decision-making scheme, we discussed the possible actions that Jennifer might take and compared their consequences. In addition, we explained the importance of ethical and legal actions referring to the PCAOB's Audit Standards(AS). I identified the ethically and legally appropriate choices for the options Jennifer faced. By gathering additional information and consulting with legal counsel, Jennifer can take proper steps to determine the seriousness of the illegal conduct. In keeping with professional ethics and industry standards, Jennifer must not overlook this issue and take appropriate action.

Word count: 1318

Reference

PCAOB. (2024). AS 2405: Illegal Acts by Clients | PCAOB . Retrieved on Nov 28, 2024, from https://pcaobus.org/oversight/standards/auditing-standards/details/AS2405

PCAOB. (n.d.) AU Section 317 - Illegal Acts by Clients | PCAOB . Retrieved on Nov 27, 2024, from https://pcaobus.org/oversight/standards/archived-standards/pre-reorganized-auditing-standards-interpretations/details/AU317

Tapajna,, J J. (2018). Ethics rule would require CPAs to discuss suspected illegal acts with clients. Retrieved on Nov 28, 2024, from https://www.thetaxadviser.com/issues/2018/feb/ethics-rule-suspected-illegal-acts-clients.html

Velasquez, M, Moberg, D, Meyer, M, Shanks, T, McLean, M. R, DeCosse, D, Andre, C, Hanson, K. O, Raicu, I & Kwan, J. (2021). A Framework for Ethical Decision Making. https://www.scu.edu/ethics/ethics-resources/a-framework-for-ethical-decision-making/