

Truth or Consequences

Topic: Internal Reporting

Characters: Dawn Sunshine, Controller of a medium-sized company
Bill Donner, In-charge CPA

Bill Donner, CPA, is the senior in-charge of an audit of a medium-sized (\$20M in assets) client, Minter Metroplex. The controller of Minter is Dawn Sunshine, CPA who had been a staff accountant with Bill's firm. Dawn left the firm about a year ago. Dawn had worked with Bill in the past. They had dated approximately five years ago, before Dawn's marriage. Bill had attempted to renew their relationship after Dawn's divorce, but Dawn had not expressed any interest in dating him.

During the year-end audit phase, Bill discovered, through his analytical review, that the gross profit ratio for Minter had been materially understated. His investigation revealed that the company failed to record last year's LCM inventory adjustment to the perpetual records. Although last year's ending inventory control balance was written down, the individual inventory cost amounts were never revised downward. Therefore, this year's gross profit and pretax were understated by \$300,000.

When Bill presented this evidence to Dawn, she agreed that her department had erred in not posting this prior year's adjustment to the subsidiary inventory records. Unfortunately, because the interim financial statements reflected these depressed earnings, the company had laid off three administrative people, including one of Dawn's assistants.

Dawn was apprehensive about bringing this omission to management's attention because of the layoffs and other corrective actions that Minter had pursued, including abandoning a \$20,000 option payment made on a parcel of land for expansion of the warehouse facilities.

Bill was sympathetic with Dawn's anxiety about disclosing this information since he felt that such an admission of oversight could have a detrimental impact on her career with Minter. Bill proposed that the \$300,000 correction could be disguised as a recent reinterpretation of the uniform capitalization rules. Management had never understood these rules, and Bill knew that their ignorance--coupled with euphoria over additional income--would not lead to any additional questions regarding this windfall. Bill suggested to Dawn that they meet for dinner and then go over to his place later to talk about it. Dawn agreed.

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