Why People Shouldn't Always Trust Their CPA (or anyone else for that matter). What Happens When Ethics Go Out The Window? Part 5

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The July 2018 issue of Journal of Accountancy once again addressed the elusive ethics in public accounting. In this issue, the emphasis was the CPA's role and ethical standards with regard to mergers and acquisitions. Although quite specific, any discussion of ethics of course also applies to the behavior of the firm in its entirety and not just as it has to do with one specific area of the practice.

This article has to do with yet another real life example of an ethical breakdown of at least one CPA within one firm and perhaps, in fact likely, more than one CPA in that firm. The article is another "installment" in the series, "Why You Can't Always Trust Your CPA or Anyone Else, For That Matter". Most people are aware that the CPA profession prides itself on its honesty, its high ethical standards, and the sometimes lofty perch it occupies in the eyes of the public. However, as in every profession, individuals or individual firms sometimes fail miserably in living up to that lofty reputation. The situation described in this article is just that, a miserable failure of ethics in an individual firm as well as individuals within that firm. The protagonist is the Chief Finance Officer ("CFO") of a mid-size public school district in Texas (approximately 3,500 ADA) and the antagonist(s) are the district board, the district superintendent, and the district's independent CPA firm ("CPA").

The CFO, when hired by the district, held a newly minted BBA in accounting. Through the years he learned his responsibilities well, did a good job, and moved up the organization ladder until he was an associate superintendent. The district was required by law, the same as all 1,100 districts in Texas, to obtain the services of an independent CPA to perform its annual CAFR. Like most of the local districts in the area, the district hired the firm "everyone else was using". Thus, the majority of the school audits were performed by the same firm with little change from year to year.

When the CFO was 55 years old he retired. The Texas Education Agency had opened a window that allowed certain individuals who had been employed prior to 1980, to purchase additional years of service and retire. So the CFO took advantage of that opening and retired. He was a high stress individual whose outside life was not treating him kindly due to a recent divorce, and he retired. The district appointed his assistant to his position. After approximately a year of retirement, the superintendent asked him to return to work. Unable to return full time due to Texas Teacher Retirement System rules and regulations, he returned part-time, approximately 4 hours per day. The district's attorney drafted an employment contract satisfactory to the district and the CFO and he returned to work for 4 hours per day.

His role was to oversee the accounting department and to ensure, because the district had experienced problems completing its audit in a timely manner the year he was gone, that that didn't happen again. So he went back to work and in retrospect he should not have done so. When he had retired it was clear he was ready to retire and he should have remained retired.

The year he returned, during that year's audit the CPA questioned an account receivable (Due from Texas Education Agency), approxumately $200,000, that had been on the books for over a year, in fact since the previous year end, the year during which the CFO was retired. Clearly the CFO should have questioned that receivable but didn't. And that was his error alone. Any time an account receivable remains on the books, particularly in a school district and that account receivable is due from the Texas Education Agency, its collectibility is doubtful at best. The Texas Education Agency is typically very prompt pay. So if an account receivable (Due from Texas Education Agency) remains uncollected for a year or more there is a problem.

The CFO should have questioned it and he should have written off that receivable against the prior year as the error that it was. However that particular receivable was specifically audited during the prior year by the CPA. In fact, they spent considerable time on that account. They questioned the receivable, they looked at the evidence, they accepted the evidence, and then they wrote a report letter containing an unqualified opinion that stated that in their opinion, the financial statements were materially correct. Of extreme importance, what was unstated and unwritten was that, in their opinion, the account receivable account (Due from Texas Education Agency), was materially correct. Had that receivable been deemed uncollectible, or doubtful, during the previous year, the district would have reported a negative fund balance position and no one was ready to see that happen. So, the CPA firm audited that receivable along with all the rest of the district's significant accounts and presented an unqualified opinion.

But now, a year later, with the account remaining uncollected, now a year later with the CFO back in charge, the auditors questioned that account receivable with the vigor they should have used the year before. And they pressed and they pressed and they pressed the CFO for new evidence that the account receivable was collectible. The CFO didn't have any new evidence. There was no new evidence. He (the CFO) spoke to the people who had been involved in the accounting office the year before and they informed him that the auditors had beaten the account receivable to death the year before before they finally issued their unqualified opinion.

But this was a new year, there was a returning CFO, and it was different. So the auditors called the Texas Education Agency to confirm with them that the receivable was collectible and of course, the rest of the story is, the account receivable was not collectible, had never been collectible. Clearly someone had to be blamed for this error. Certainly it could not be the fault of the superintendent (who was there the year the error occurred), it could not be the fault of the board (all of whom were there the year the error occurred), it couldn't possibly be the fault of the CPA who audited the financial statements the year the error occurred, and issued an unqualified opinion on those financial statements, and it could not be the fault of the attorney. Well then, who to blame? Someone had to be blamed. So the blame fell on the CFO who wasn't even working, at the district or anywhere else, the previous year, the year the error occurred.

The district's attorney, the superintendent, and the president of the board all threatened the CFO and told him that they were going to find a way to have the Texas Teacher Retirement System reduce his pension check until that $200,000 receivable was paid, by him. So the CFO confided in several friends and professionals and was assured by all that there was no way the district could influence the Texas Teacher Retirement System to reduce his check to pay the amount of that account receivable and furthermore he was advised to retain the services of an attorney and depose the district's CPA and other CPAs in the firm, whether they had worked on either the previous year audit or the current year audit or merely reviewed workpapers and demand access to any workpaper related to the audit of the account receivable balance.

Now of course the CFO should have detected the error during the year. He failed in that responsibility. But he did not record the balance in error during the previous year. He didn't prepare any audit schedules the previous year. And he certainly didn't audit the financial records. Someone else had incorrectly recorded a $200,000 account receivable. Someone else had prepared prior year audit schedules. And most important of all, someone else had audited the financial records, looked at the account, accepted the validity of the account, and issued an unqualified opinion. So any blame should have been laid squarely at the feet of the district and the CPA who audited the records. This was an audit bust. This was a material error. But naturally there was to be no acceptance of responsibility by either the district or the district's CPA. The CPA was not going to admit responsibility for an audit bust. He has other clients you see, clients who may be concerned to read about such an audit bust in the local newspaper. So they joined the effort to intimidate the CFO and cause him to timidly disappear, which is exactly what he did. The district continued on with their efforts, the superintendent was off the hook, the board was off the hook, and the CPA was off the hook.

Finally, the CPA proposed an adjusting entry that caused the district to write off the $200,000 receivable. It's almost certain that the entry was recorded against the current year activity instead of recording an error in prior year. The superintendent retired a few years later with a very nice pension and a clean record. The CPA continues to enjoy a very large practice in governmental audits. The CFO died of cirrhosis of the liver a few short years later.

Should you always trust your CPA? Or anyone else for that matter?