

Appendix B – Real Businesses – Real Impacts

The pressures on the audit and assurance market aren't hypothetical. Here are just three accounts of actual Ontario business transactions that could not proceed because of the risk of the audit assignments involved. These case studies were provided to the Institute by audit firms. For business confidentiality reasons, all references to the actual companies in question have been removed.

Example 1

“A company involved in leasing fixed large assets for many years had maxed out its finances and had used securitization to pool assets and come up with needed funding. It was still a decent company but it was highly leveraged, although not to the point of breaching its debt covenant. Normally we would have accepted an engagement to work with the management and help them turn the company around. The company required an audit, which we wouldn't accept because the risk of failure might expose the firm to litigation even if the audit wasn't negligent. They were denied access to the audit they needed to help obtain required financing.”

Example 2

“We were approached by a relatively new company in the audio networks business. They were proposing to enter a new field and wanted to set up a system to charge people for uploading and downloading music from a website. To do so, they'd need to go public to raise funding. They were honest and capable people and the business looked viable. But, in today's environment for assessing risk, this business still looked too new and unproven. Emerging industries are always vulnerable, whether it is to changes in technology or other unknown factors. We wouldn't take their business or help with their IPO.”

Example 3

“An established business selling household soft goods wanted to hire our firm as auditors. We looked and found that, while they were well capitalized, they had engaged in some inventory financing. Their market was increasingly competitive and, in Canada, a mature one, which necessitated the product having to be sourced offshore. We felt that the commoditization of the product was resulting in declining profit margins and that, at some future point, this company could face financial difficulties. If that occurred, and a lender had to realize on the inventory, the lender could sustain significant losses. That could in turn result in the lender coming back and look at the audit, with the intention of tagging the auditors to recoup some of their losses. The risk in that scenario was too high, so we declined the audit work, even though the company was not currently in any trouble.”