Erinbuild Contractors – Professional Skepticism on a High-Risk Audit

Erinbuild Contractors was a very large contracting company based in Canada, with operations concentrated in Ontario and Quebec. It was having trouble with its debt covenants and profitability was suffering for various reasons, some of them beyond its control. Because of this its auditor issued instructions to all its staff to exercise extreme skepticism about big numbers. The company was known to skate close to the edge, but no fraud or impropriety had been noted at the corporate level.

One very large project to build a bridge across the St. Lawrence River had over $20 million of deferred costs and it was decided by the auditors that they should ensure they were recoverable. It was very early January when they planned to send one of their smartest junior staff to visit the site. Head Office said that the bulk of the deferred costs was represented by steel purchased for construction, which had been deferred to the spring due to very harsh winter weather conditions. They said visiting the site would not be very productive because everything was buried in snow and there would therefore be nothing to see.

But the staff member was sent anyway. On arrival it was indeed bleak; he feared frostbite and longed to get back into his rented car and head back to Québec City airport. However he persevered and asked if snow could be cleared off at least a portion of the pile so that he could see the steel. The project superintendent said there was no snow clearing equipment on site and that it would take a couple of hours for him to order some. The auditor still insisted, at which the superintendent went indoors to make a phone call. When he returned he confessed that there was almost no steel under the snow. Late in the year the steel had been piled too close to the river and after a major rainstorm most of the steel had slid into the river and was probably not recoverable or, if it was, recovery would be costly. He said he had not told Head Office, but the auditors were sceptical about this and thought Head Office wished to hide this information until after this year’s financial statements were finalized and audited.

So a large write down had to be booked and the company had to renegotiate its lending agreement at some cost. The auditors never knew for sure whether Head Office deliberately kept this quiet, but in future audits, and for the remainder of this one, their alert level was much enhanced.

Incidentally, in the same audit on a different site visit, the auditors were provided with a list of equipment on site and decided to check it. This was a very long site (They were building a section of Highway 401) and despite their best efforts they could not find all the equipment listed, which they reported back to Head Office. It turned out that the project superintendent had been renting out equipment to local contractors and pocketing the cash. This was only employee fraud and did not have a material impact on the financial statements.

Questions:
1. The auditors of Erinbuild found several problems, and potentially two frauds because they recognized the client as high risk. Identify the problems and the frauds.
2. What Erinbuild governance and ethics issues are implied by the problems and frauds?
3. How important are site visits in audits?
4. How should auditors react when they suspect that their client is trying to encourage them to not perform a procedure they wish to perform?
5. What is the most admirable about this audit?
6. What procedures other than a site visit might have detected the problem?
7. Was this fraudulent? If so, who by?

Source: Professional Skepticism Case Collection for Professional Accountants, University of Toronto Professional Accounting Centre, 2023, PAC website https://www.utm.utoronto.ca/pac/case-collections/enhancing-professional-skepticism-case-collection.