4-19-1994

Financial Statements with Environmental Concerns: An Exploratory Study of the Impact on the Auditor's Role and Responsibilities

Lori Burton
Western Kentucky University

Follow this and additional works at: http://digitalcommons.wku.edu/stu_hon_theses

Part of the Finance and Financial Management Commons

Recommended Citation
http://digitalcommons.wku.edu/stu_hon_theses/62

This Thesis is brought to you for free and open access by TopSCHOLAR®. It has been accepted for inclusion in Honors College Capstone Experience/Thesis Projects by an authorized administrator of TopSCHOLAR®. For more information, please contact topscholar@wku.edu.
FINANCIAL STATEMENTS WITH ENVIRONMENTAL CONCERNS: AN EXPLORATORY STUDY OF THE IMPACT ON THE AUDITOR’S ROLE AND RESPONSIBILITIES

Lori A. Burton

April 19, 1994

Dr. Janet L. Colbert

Thesis Director

Dr. Jack Hall

Department Representative

Dr. Sam McFarland

Honors Program Director
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Federal Laws That Affect Financial Statement Presentations</td>
<td>3</td>
</tr>
<tr>
<td>Resource Conservation and Recovery Act (RCRA)</td>
<td>3</td>
</tr>
<tr>
<td>Clean Air Act</td>
<td>4</td>
</tr>
<tr>
<td>Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)</td>
<td>4</td>
</tr>
<tr>
<td>Auditor’s Liability</td>
<td>4</td>
</tr>
<tr>
<td>The Impact of Environmental Concerns on the Audit</td>
<td>6</td>
</tr>
<tr>
<td>The Auditor’s Responsibility to the Client</td>
<td>6</td>
</tr>
<tr>
<td>Using the Work of a Specialist</td>
<td>7</td>
</tr>
<tr>
<td>Is There a Potential Need For Specialization Among Auditors of Environmentally Influenced Financial Statements?</td>
<td>9</td>
</tr>
<tr>
<td>Discussion of the AICPA’s Accreditation of Specialists</td>
<td>12</td>
</tr>
<tr>
<td>The Pro Views of James Shambo</td>
<td>13</td>
</tr>
<tr>
<td>The Con Views of Sheldon H. Eveloff</td>
<td>14</td>
</tr>
<tr>
<td>Comments on the Opposing Views</td>
<td>16</td>
</tr>
<tr>
<td>Legal Liability and Its Effect on the Auditor’s Role</td>
<td>17</td>
</tr>
<tr>
<td>Interpretation of Accounting Standards as a Source of Auditor Liability</td>
<td>19</td>
</tr>
<tr>
<td>Auditor Liability Inherent in Environmentally Influenced Financial Statements</td>
<td>21</td>
</tr>
</tbody>
</table>
Problems Associated With Interpreting Accounting and Auditing Standards 21
Accounting For Various Line Items in the Financial Statements 22
The Auditor’s Role as a Potentially Responsible Party 24
Practices That Could Help Minimize Auditor Liability 25
Before the Audit Engagement Begins 25
During the Engagement 26
After the Audit Engagement 31
During the Auditor’s Career 33
Analysis of the Issues 35
Concluding Comments 43
Bibliography 46
Oral Defense of Senior Thesis

FINANCIAL STATEMENTS WITH ENVIRONMENTAL CONCERNS: AN EXPLORATORY STUDY OF THE IMPACT ON THE AUDITOR’S ROLE AND RESPONSIBILITIES

Lori A. Burton, Senior Accounting Major

Thesis Director: Dr. Janet L. Colbert

10:45 a.m., Tuesday, April 19, 1994
Dean’s Conference Room (449 Grise)
FINANCIAL STATEMENTS WITH ENVIRONMENTAL CONCERNS: AN EXPLORATORY STUDY OF THE IMPACT ON THE AUDITOR'S ROLE AND RESPONSIBILITIES

INTRODUCTION

In recent years, the environment has become increasingly important for many individuals and groups. Actions geared towards cleaning up the environment are prevalent. Businesses, with the help of persuasion by the government, have become concerned with conducting business in such a way as to reduce damages occurring in the environment. However, the road to environmental awareness has a few potholes. As businesses grow, their expansion tends to be hindered by stringent regulations set forth by the Environmental Protection Agency, the Securities and Exchange Commission, and other governmental bodies. Furthermore, environmentalists are lobbying for even stricter laws to regulate businesses, particularly in the chemical and manufacturing industries.

Businesses are not the only parties affected by these regulations. The auditors who examine a company's financial statements that reflect environmental concerns are seeking guidance for these environmental issues. Several Statements on Auditing Standards and a few Statements on Financial Accounting Standards provide guidance to the auditor. The Standards deal with the use of specialists, illegal acts, contingencies, client representations, and disclosures.
Examining financial statements which reflect environmental issues is a fairly new concept to the auditing profession. Despite much discussion, not all environmental accounting issues have been resolved. For example, much discrepancy still exists in the way that environmental contingencies and EPA emissions allowances are accounted for in the financial statements. Also, because the profession's guidance on environmental issues focuses on compliance audits, little guidance is available concerning financial statement audits.

The responsibilities of the auditor have not changed since the introduction of auditing of financial statements for environmental concerns. The auditor is still responsible for examining the statements thoroughly to ascertain whether or not they are fairly stated in compliance with generally accepted accounting principles. However, in light of environmental issues, the role and responsibilities of the auditor must be reexamined.

The auditor's opinion is normally based on direct critical scrutiny of the financial statements and professional judgment. However, when environmental issues are included in the financial statements, the auditor may rely heavily on the representations by the client and possibly use the work of the environmental specialist. Information about environmental issues obtained indirectly through the client or a specialist is not as reliable as information obtained directly by the auditor. So, a need for the auditor of environmentally-influenced financial statements to obtain further knowledge about environmental laws and regulations is apparent.
In the following discussion, accounting for environmental transactions and the auditor's role when performing financial audits with environmental implications are explored. The paper is an in-depth, exploratory study of the existing accounting standards statements and professional writings and their implications on audits of financial statements with environmental aspects.

**FEDERAL LAWS THAT AFFECT FINANCIAL STATEMENT PRESENTATIONS**

Governmental bodies, both on the national and state levels, have made attempts to provide regulations, laws, and guidance to individuals and companies who must contend with environmental issues. These attempts focus on the premise of eliminating or minimizing damages to the air, water, soil, and human lives. Several federal laws deal with environmental concerns and may impact financial reporting of such issues. Some of these laws are described below.

**Resource Conservation and Recovery Act**

The Resource Conservation and Recovery Act (RCRA) established a comprehensive program for managing hazardous materials from their creation to their disposal. The Act includes controls on underground storage tanks. This act is intended to prevent events that lead to contaminated sites and reduces the need for future clean-up costs. RCRA establishes responsibility for monitoring, transporting, treatment, storage, and disposal of hazardous wastes.
Clean Air Act

The Clean Air Act addresses air pollution controls. Permits for industry and vehicles are issued according to the provisions of the Act. Clean Air Act Amendments of 1990 are intended to reduce pollution by imposing restrictions on public utilities to minimize emissions of sulfur dioxide and nitrogen oxides into the air. Emissions limits are established for each utility and annual allowances authorize the limits that can be emitted. To remain in compliance with the Clean Air Act, utilities may either acquire additional allowances or incur expenditures to reduce the emissions produced by their generating units.

Comprehensive Environmental Response, Compensation and Liability Act

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), often referred to as Superfund, initiated a program requiring responsible parties to clean up contaminated sites. This legislation requires that companies incur costs for the remediation of the contaminated site. The liability under this act is strict, joint, and several.

AUDITOR'S LIABILITY

When conducting an audit of financial statements with environmental implications, an auditor’s opinion of the fair representation of the statements is particularly crucial. Bewley observes that the auditors could unintentionally present themselves "as having the ability to assess environmental matters that are outside their
traditional knowledge and expertise" [1993]. To substantiate their opinion, auditors can seek the advice of a specialist for areas in which they have little or no knowledge or skill.

Regardless of whether the auditors use an environmental specialist, external parties and/or management may initiate lawsuits that could cause permanent damage to the auditor's professional status and credibility. The expectations of society have increased since the audits of financial statements with environmental implications entered the picture. The auditor must be aware of these additional expectations and be prepared for potential litigation.

A professional code of ethics and generally accepted auditing standards (GAAS) require that the auditor adequately design and perform the audit with professional duty of care. Bewley believes that it is illogical to conclude that the auditor is liable for management's neglect to anticipate costly environmental damages, especially when the auditor bases the opinion on GAAS [1993]. The auditor's duty of care is challenged when such skepticism arises from society's concerns. Therefore, the auditor must practice due care throughout the audit, both directly and indirectly. Indirectly, the auditor should consult specialists for additional guidance and make inquiries of management's intent to account for potential environmental contingencies.
THE IMPACT OF ENVIRONMENTAL CONCERNS ON THE AUDIT

As auditing for environmental issues becomes more significant, auditors face many challenges. The auditor must be concerned with the determination of the point at which an environmental issue becomes a financial liability. Also of concern is the fairness of the amount of the cost estimate presented in the financial statements [Thomson, Simpson, and Le Grand, 1993].

THE AUDITOR'S RESPONSIBILITY TO THE CLIENT

When performing the audit engagement, the auditor should be aware of items that the client may have overlooked, including contingent liabilities related to environmental issues. The auditor must, therefore, be cognizant of federal, state, and local regulations that may impose civil, judicial, and administrative fines for environmental infractions [Pitre 1993]. Furthermore, the auditor must uphold the third standard of field work. The standard states that the auditor should have sufficient competent evidential matter to provide a reasonable basis for an opinion of financial statements [Statement on Auditing Standards (SAS) No. 1, 1973]. To obtain sufficient competent evidential matter, the auditor should conduct adequate tests, observations, inquiries, and confirmations. If the auditor does not possess the skills or knowledge to make a reasonable conclusion, the work of a specialist may be used. (This item shall be discussed in a later section.)
According to SAS No. 59, "Going Concern," the auditor has the responsibility to evaluate whether or not the entity is capable of continuing as a going concern [AICPA, 1988]. In connection with this, SAS No. 54, "Illegal Acts," relates to the client's violations of government laws and regulations [AICPA, 1988]. The auditor should make certain that the client has accounted for potential environmental liabilities in an appropriate manner before issuing an unqualified opinion.

**USING THE WORK OF A SPECIALIST**

According to the Proposed Statement on Auditing Standards, "Using the Work of a Specialist," a specialist is a person who possesses a special skill or knowledge in a particular field other than accounting or auditing [1993]. An auditor may use the work of a specialist when:

1. management engages a specialist to prepare or assist in the preparation of portions of the financial statements and the auditor intends to use the work as evidential matter,

2. management uses a specialist employed by the auditor's firm to provide advisory services and the auditor intends to use the work as evidential matter, or

3. the auditor engages a specialist and intends to use the work as evidential matter.

The auditor is not expected to be specifically trained for or qualified to engage in the practice of another career or profession other than accounting and auditing.
Therefore, the use of a specialist to assist in the audit may be more efficient and may help reduce or even prevent auditor’s liability problems.

When deciding to utilize the work of a specialist, the auditor should consider various criteria. First, the specialist should be competent. To demonstrate competence, the specialist could have professional certification or license. Second, the specialist’s reputation and standing among peers and associates is considered. Third, the specialist’s experience in the area of work utilized by the auditor must be examined. When the auditors consider these criteria, they must recognize that their choice to use the specialist could raise questions of liability. If the specialist fails to disclose complete and accurate information that would have affected the auditors’ opinion of the financial statements, then the auditors could face greater liability risk. Furthermore, if the information had been disclosed, the auditors would have been able to design an audit program that contains additional tests for completeness of the client’s financial statement disclosure.

Once the auditor obtains the specialist’s findings, the findings should be evaluated for suitability for supporting financial statement representations. The auditor should compare the specialist’s conclusions with those accounting data provided by the client. If the auditor believes that the findings are unreasonable, additional procedures should be applied. These additional procedures include, but are not limited to, obtaining a second opinion from another specialist.
IS THERE A POTENTIAL NEED FOR SPECIALIZATION AMONG AUDITORS OF ENVIRONMENTALLY INFLUENCED FINANCIAL STATEMENTS?

Under CERCLA, the responsibility for hazardous-waste cleanup liability is imposed upon an extensive group of potentially responsible parties (PRPs) [Zuber and Berry, 43]. PRPs include the following parties:

1. the owner or operator of the identified hazardous site,
2. the owner or operator of the site at the time of disposal of hazardous substances (i.e., past owners and operators),
3. creators of the substances disposed of at the site, and
4. transporters of the hazardous substances to the site.

However, the above list is not all-inclusive. Strong support for this can be found in the exposure of environmental violations of a publicly-owned facility. In face of financial losses, those people who maintain an interest in a facility (i.e., stockholders and lenders) might accuse a wide variety of parties associated with the business. Such parties may include anyone from the owners and operators to the financial statement auditor. Placing the blame on the owners and operators is not unexpected, for, regardless of whether they knew of the act, they are the parties who directly violated the law. However, the accusing parties may also hold the auditor of the financial statements potentially liable for not detecting the errors.
When entering into an audit of financial statements with environmental consequences, the auditors should exercise due care to protect themselves from potential professional liability. Under SAS No. 54, "Illegal Acts," the auditor is provided guidance on the nature and extent of the auditor's consideration of the client's possible illegal acts, audit planning and performance, and the auditor's responsibility if such an act is discovered [AICPA, 1988]. SAS 54 also states that it is not the auditor's responsibility to determine whether or not an act is indeed illegal. That determination should be made based upon a legal expert's advise or a decision made by a court of law. If the auditor suspects that an illegal act has occurred, SAS 54 provides a list of actions the auditor should take. These include consulting legal counsel, performing additional audit procedures, and making inquiries of management.

If an illegal act is confirmed, the auditor is bound to report the illegal act. SAS 53, "The Auditor's Responsibility to Detect and Report Errors and Irregularities," states that the auditor should report the error or irregularity to the audit committee of the client's board of directors if it has a direct and material effect on the financial statements. When further investigated, the error or irregularity could prove that an illegal act has occurred.

At this point, it must be understood that the auditor is not, in any way, trained to detect all irregularities, errors, or illegal acts during the audit. However, under SAS Nos. 53 and 54, the auditor must pursue, with reasonable, diligent, and
competent professionalism, any possible material findings until a satisfactory conclusion is reached.

During the examination, the auditor should be aware of potential environmental liability red flags [Specht, 70-71]. Specht suggests discoveries of red flags may be obtained through client inquiry, analytical review, review of the corporate minutes, review of legal documents, transaction tests, audits of various accounts (cash, notes receivable, notes payable), and reviews of insurance coverage. She suggests the following red flags:

* Participation in real estate or merger-consolidation transactions

* Borrowing or lending at higher-than-expected interest rates

* Possible bargain sales that are due to high environmental risks

* An environmental audit was authorized or performed

* Real estate transactions that fell through where the client was the seller, particularly those in which the client paid additional legal and professional counsel

* Client obtains insurance coverage to protect against third party claims

* Client sets up a slush fund account to cover unexpected costs which may include environmental clean-up projects
These are just a few of the many items that the auditor should be aware of while performing the audit. It is very clear that the auditor should attempt to further investigate these red flags through inquiries of the client, the client’s attorney, and the specialist.

However, auditors are obligated to perform their work within certain time frames. Obviously, auditors should be provided with some guidance as to how serious the act in question must be before surpassing the allotted time for the audit engagement. Currently, no guidance is available in the professional standards regarding the further investigation of environmental issues.

**DISCUSSION OF THE AICPA’S ACCREDITATION OF SPECIALISTS**

Currently, the AICPA offers only one accredited specialization, personal financial specialists (PFS). Individual states utilize the examination services of the AICPA to offer the professional designation, Certified Public Accountant. This allows an accountant to practice in the public sector while performing a wide range of duties. Special task committees are encouraged by the AICPA to suggest new specializations that could be incorporated in the AICPA’s offerings to members. However, there has not been any mention of a specialized designation for auditors of financial statements with environmental implications. The following discussion will serve to present pro and con views of accrediting specialists and concluding comments on the issue.
The Pro Views of James Shambo

James Shambo, a managing partner of Sanden, Shambo, and Anderson in Colorado Springs, Colorado, suggests that "specialization has been accepted by most as the inevitable progression of today's professional during their careers" [Shambo and Eveloff, 41]. He notes that the specialization issue arose out of the rapid changes occurring in the profession during the inflationary years of the 1970s and 1980s. At the time, accreditation was perceived as a means to distinguish those individuals who were experienced enough to adequately help clients with their investment and financial concerns and decisions.

Shambo believes that the public would benefit greatly from accreditation of professionals. First, the public would be provided with proof of specialty knowledge among accounting professionals. Second, accreditation would improve the CPA's competency in specialized skills.

The profession would benefit from accreditation as well. The government has allowed the AICPA to be a self-regulatory agency. The public, companies, and other related parties allege that the profession has failed "in our obligation to the public trust" [42]. However, the profession has been able to shield itself from these allegations through peer reviews and continued professional education requirements. Accreditation would be one means of substantiating that the profession is trying to promote the best performance from accountants.
Other benefits of accreditation include the ability to compete with other organizations outside the profession, a means to depict accounting as a dynamic profession, and a means to help in the efforts to create uniform standards in all jurisdictions. The public often seeks advice outside of the profession in the areas of financing and investing. With the help of accreditation, the profession can further expand its abilities to perform in situations other than financial statement audits and tax preparation.

Accreditation can also attract more people to the profession. For instance, specialization would help revolutionize the profession from one of "number-crunching" to financing and investing counseling.

Accreditation of specialists would also allow the profession to impose uniform standards in all jurisdictions that recognize the AICPA guidelines in state level standards. The AICPA has been working on standardization for years. If feasible, accreditation would provide the perfect means to achieve this goal.

The Con Views of Sheldon H. Eveloff

Sheldon Eveloff opposes Shambo's views and believes there is no justification to add more designations to those specialties that exist. His reasons for this opinion are very clear. If specializations are continuously added to the profession, the list could go on to infinity, causing confusion both inside and outside the profession. He believes that standardization would cause a great deal of overlap and redundancy. Furthermore, specialization would require the accountant to have a very broad range
of skills that may or may not be interrelated to accounting, thus, creating a "jack-of-all-trades." In the public eye, the accountant should be an accountant, not a financial analyst or investment broker. This problem would further raise questions of professional competency. If an accountant desires to have an extensive list of specializations, it would be difficult to satisfy the amount of experience and continuing professional education (CPE) requirements to maintain all designations.

Eveloff believes that specialization would be very costly. First, smaller firms may not be able to compete with the larger, more specialized firms. Second, to maintain accreditation, specialists would be required to fulfill extensive CPE requirements set by state licensing boards. Third, the AICPA might indirectly fund administrative and monitoring expenses with membership fees (which could increase to enormous rates).

Eveloff also believes that accreditation would inevitably create liability headaches. The public would tend to view unaccredited CPAs as incompetent when compared to their fellow specializing professionals. It may also be assumed that if a specialist performs tasks that are outside the specialty area (e.g., tax preparation), then the accountant is not able to perform quality work. These public perceptions would create an additional source of liability since general consensus would condemn the accountant who has no area of expertise. Eveloff also challenges the notion that accreditation would be a means for monitoring and improving practice quality in an
effort to reduce liability. He states that one established, less expensive way for the profession to minimize liability is peer review.

Comments on the Opposing Views

At first, accreditation appears to be a very feasible way of dealing with the public’s concerns of competency among accounting professionals. However, when the costs are factored in, specialization is not a viable option in most instances. Eveloff does not consider the potential liability that professionals face when they enters unfamiliar territory. Auditing financial statements with environmental concerns would represent a potential candidate for accredited specialization.

The auditors face liability any time they enter an audit engagement. However, auditors have the right to refuse to take on a client’s account if they believe there is a high degree of risk. The professional is encouraged to use extensive care when selecting clients to serve [Guy, Alderman, and Winters, 461]. Firms have no obligation to accept every client, particularly when possibilities of increased business risk, on the part of the auditing firm, are present. Auditing financial statements with environmental implications could introduce a high degree of risk regardless of the other risks involved (e.g., client representation, hidden costs and liabilities).

For auditors of financial statements with environmental implications, specialization would be feasible. Specialization would afford them the opportunity to learn to detect and explore environmental red flags and to understand the federal, state, and local laws that affect representations in the financial statements.
Specialization could also provide them with the image of competence and knowledge should they be implicated in a lawsuit. In the meantime, it would be to the auditor’s best interest to gain some kind of knowledge of environmental factors that may present themselves in the financial statements. One suggestion is to provide optional continuing professional education programs which teach the auditor to be aware of certain things. Another suggestion is to encourage the AICPA to open an investigation of the environmental issues that have come to light and issue guidance to the auditors in the way of official standards or task force bulletins.

LEGAL LIABILITY AND ITS EFFECT ON THE AUDITOR’S ROLE

O’Malley’s commentary reveals an evident need to explore the effects of legal liability on the role of the auditor [82]. In United States vs. Arthur Young, the court found that auditors are responsible to the public, as well as to shareholders, when they certify that financial reports adequately reflect the company’s financial status. O’Malley doubts that the court considered that the auditor’s role is not solely to detect financial fraud. Instead, he notes that the independent auditor has the more important role of serving the public interest.

Another area of conflict that O’Malley points out is the differences that exist in the interpretation of accounting standards. Many of the decisions that an auditor makes while performing the audit are made in accordance with loose interpretation of the standards and professional experience.
While O'Malley is in favor of improving the auditor's ability to protect the public against fraud, he is "fearful that an expansion of the auditor's responsibilities could prove fatal as long as the liability system remains little more than a risk transfer mechanism and auditors are regarded as prime transferees" [83]. If auditors take precautions to explore questionable areas of the financial statements, they should not become the primary target for blame and retribution for environmental contingencies that go undetected. After all, independent auditors are not specifically trained to be fraud examiners. However, the auditor may be perceived as doing nothing to prevent, minimize, or "predict" the possible future losses [O'Malley, 83]. Management should be more responsible for potential losses since it has control over the company's activities. Nonetheless, the public may accuse the auditors of not completely or competently performing their duties while conducting the audit if the client faces potential losses.

O'Malley states that management should be responsible for compliance with government laws and regulations [86]. Auditors should not be solely responsible for assuring the shareholders and other parties interested in the financial statements that management is in compliance with specific regulations. Instead, auditors should review management's decisions and report their opinions to the financial statement users. The ability of the auditor to perform this service depends on the auditor's competence and familiarity with laws and regulations that govern the audited company.
Current practice dictates that auditors should report fraud and other problems detected during the audit to the board of directors (i.e., the audit committee) or to management. This method of reporting irregularities and misstatements is intended to protect shareholders from learning of the problems before management has a chance to correct the problems. O'Malley suggests that auditors should be permitted to disclose discrepancies directly to federal and state regulators [86]. Under the Financial Fraud Detection and Disclosure Act (H.R. 574), auditors are required to report suspected material fraud to regulators only if management and the board of directors fail to exercise their responsibilities to the financial statement users. This bill has "a safe harbor for what auditors disclose" [86]. However, the law assumes that the auditor can easily decide the amount of information that should be disclosed and when to disclose it. The law also presumes that the auditor has the ability to detect the fraud before it causes an extensive amount of damage. Thus, the risk of litigation for disclosing the situation is potentially greater since no specific guidance for environmental disclosures exists.

**INTERPRETATION OF ACCOUNTING STANDARDS AS A SOURCE OF AUDITOR LIABILITY**

Aside from the obvious accusations from the stockholders and the public in general, an auditor also faces potential professional liability from varying interpretations of generally accepted accounting principles by the financial statement preparers. As evident in commentaries from members of the profession, for any one
principle, there may be many interpretations and applications. As a result of different interpretations, transactions found in the financial statements from the same type of business may vary greatly. This difference may be attributed to the way in which an accountant perceives the form of a transaction. According to Schuetze, accounting for the substance of an event over its form would indicate that the need for standards would be eliminated [Schuetze, 89]. In the worst case scenario, financial statements of companies operating within the same industry would have little comparability, consistency, or understandability from financial statement users.

When auditing a company, the auditor must determine how the preparer of the financial statements interpreted the standards dealing with such items as contingent liabilities, research and development costs, and goodwill amortization. When estimating these items, the preparer of the financial statements must use a certain degree of personal judgment when applying accounting standards to transactions. Likewise, the auditor must apply judgment when auditing the work of a fellow accountant. However, the method that one accountant considers to be correct might be considered incorrect by another accountant. Schuetze notes that such judgment calls could cause costly legal debates as a result of complex and ambiguous accounting standards.
AUDITOR LIABILITY INHERENT IN ENVIRONMENTALLY INFLUENCED FINANCIAL STATEMENTS

Problems Associated With Interpreting Accounting and Auditing Standards

In environmental reporting, the problem of standardized interpretation is also present. However, the need for professional guidance in this area is relatively new. Uncertainties exist in the way in which accountants depict environmental costs, when to report the cost, and how to measure the costs. The accountant must decide whether to capitalize or expense the cost. A judgment must be made with regard to the recognition of a contingent cost now or waiting until the cost becomes more imminent. Johnson notes that often it is the difficulties associated with recognition that make reporting environmental outlays impossible; the only recourse may be disclosure in the footnotes [118]. Without specific guidance provided in the financial statements or authoritative literature, reporting environmental costs is reduced to professional judgment. The closest thing to authoritative guidance rests primarily in selected FASB standards combined with an interpretation and several of the FASB’s Emerging Issues Task Force reports. In addition, registrants of the Securities and Exchange Commission (SEC) must comply with its disclosure requirements.

Auditors of environmentally influenced financial statements are exposed to potential liability since they must rely on existing standards which tend to be modified by their judgments of proper application to environmental issues. For example, the question of when a contingent liability should be recognized arises. FASB Statement
No. 5, "Accounting for Contingencies" defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty...that will be resolved when one or more future events occur or fail to occur" [SFAS 5, 1975, par. 8]. Under Statement 5, contingencies should be recognized as losses when it is probable that a liability has been incurred or an asset has been impaired and the amount of the liability or impairment can be reasonably estimated.

While Statement 5 provides a definition of what a contingency is and when contingent losses should be recognized, the measurement of the contingency is left up to the accountant's judgment. However, FASB Interpretation 14, "Reasonable Estimation of the Amount of a Loss," does provide limited guidance [FASB Interpretation 14, 1976, par. 3]. It states that when the reasonable estimate of a loss is a range and no amount within the range is a better estimate than another, the minimum amount should be accrued. One question that arises is what is a reasonable amount? How is it determined? Once again, the accountant must use professional judgment to make that decision.

Accounting For Various Line Items in the Financial Statement

Correlated with the interpretation of accounting and auditing standards, the problem of how to account for various environmentally influenced line items is present. For example, through the Clean Air Act and its amendments, the EPA has granted air pollution emission rights to various industries which allow them the emission of one ton of sulfur dioxide in a given year. However, the profession has
raised some questions with regard to how these emissions should be accounted for. Many business people, including accountants, have foreseen a market for selling these emission rights [Ewer, Nance, and Hamlin, 69]. For now, the profession needs to focus its attention on answers to such questions as how emissions should be accounted for and how they should be classified.

In many ways, the emissions allowances resemble securities that can be bought and sold on the open market. The emission rights also carry some characteristics of personal property; heavy emphasis is placed upon the right of the industry to use its emissions allowances however and whenever it wants. Yet another view holds that emission rights should be accounted for as inventory which is eventually expensed as it becomes used up or as it becomes part of the cost of goods sold in a finished product. Still another view contends that the rights represent an intangible asset, like a license, that can be amortized over a given life. However, since the grant of emission rights typically covers a period of approximately one year, the amortization of the rights as an intangible asset appears incorrect. Regardless of how the emission right is accounted for, the fact remains that there needs to be more guidance in this area.

As discussed in a previous section, contingent liabilities may exist on the books of the client. While the standards try to answer some questions about contingencies in general, there is no specific guidance for the auditor in determining the exact nature of
potential environmental contingencies. Consequently, the auditor may become liable for environmental contingencies that remain undiscovered in the course of the audit.

The Auditor’s Role as a Potentially Responsible Party

As noted previously, potentially responsible parties are those who are involved in the creation and disposal of environmental wastes. However, the auditor faces the risk of being indirectly liable for the wrongful acts of its client if the auditor fails to detect potential problems. Furthermore, if remediations are not taken by the client to correct the problem once it is detected, the stockholders, creditors, and other parties may blame the auditor for not ensuring that the client corrects the problem.

One problem exists with this line of rationale. The auditor does not have the authority of management to correct potential problems that arise in environmentally influenced financial statements. However, the public does not realize that the auditor’s primary role is to attest that the statements are in conformance to generally accepted accounting principles, not to correct the technological or environmental problems of the client. However, if the auditor does detect potential environmental contingencies that may require disclosure within the financial statements or the footnotes, the audit committee of the client should be informed of the findings. Hypothetically speaking, aside from this obligation, the auditor should not be liable for the cleanup costs should litigation arise in the future.
PRACTICES THAT COULD HELP MINIMIZE AUDITOR LIABILITY

There are many practices and precautions that could help the auditors reduce their exposure to liability risks. These practices can occur before, during, and after the audit engagement. There are also practices that auditors could pursue throughout their careers. The following discussion explains these practices; however, it is not intended to be all-inclusive.

Before the Audit Engagement Begins

Although not required, the engagement letter is an informal contract between the client and the auditor. Usually signed by both the client and the auditor, the engagement letter spells out exactly what the audit entails, the parameters of the audit, the payment to the auditor, and the obligations of the auditor to the client to report the findings to the client. According to Gary Boomer, a CPA, partner, and stockholder in Varney and Associates, Manhattan, KS, auditors are "going to have to write our engagement letters on some of these projects tighter, so that when we find additional work, we issue change orders, much like they do in the construction business" [Cohn and Herter, 36]. The rationale for this flexibility of the engagement letter is that many times, problems arise during the audit that neither the auditor nor the client realize from the beginning. Consequently, the auditor may have to take the loss for the extra time involved in completing the audit since the extra fees were not allotted in the letter.
In the case of environmentally influenced financial statement audits, this flexibility is needed. The auditor may come across potential environmental issues that require further exploration for adequate attestation of the financial statements. However, the auditor must sacrifice both time and money to complete the engagement to meet professional standards.

**During the Audit Engagement**

**Client Representations**

Client representations, obtained during the audit as part of the evidential matter, are similar to the engagement letter. These representations are an expression of management's knowledge of the content of the financial statements. However, one major difference is that the client representations are required and, if received, are documented in the working papers [SAS 19, AICPA, 1977]. The client representations can be secured through oral or written responses to specific inquiries or through the financial statements. Such response could be found through the examination of the business purposes of transactions, documents (e.g., contracts and invoices) related to transactions, and the board of directors' meeting minutes. Through this collected information, the auditors obtain knowledge of related parties, potentially responsible parties in contingent liability issues, and potential violations of federal, state, and local laws and regulations.
Client representations provide the auditor a "springboard" from which to narrow the focus of the audit to material and/or specific areas to investigate. For instance, these representations could provide the auditor with knowledge of potentially responsible parties and the internal control structure. This collection of information helps the auditor assess the audit risk, materiality measurements, and possible tests of control to assess whether or not the client is in compliance with and has properly recorded significant environmental transactions according to specified laws and regulations.

Lawyer’s Letter

Management is responsible for identifying, evaluating, and accounting for litigation, claims, and assessments for the preparation of the financial statements [SAS 12, AICPA, 1976]. SAS 12 suggests that any further inquiries regarding legal matters should be obtained through the client’s legal counsel. The lawyer’s letter is one practice that can limit the auditor’s liability with respect to the discovery of potential contingencies such as pending litigation. There are two types of lawyer’s letters. One type is a letter written to the lawyer in which the auditor writes down all of the possible legal contingencies and the lawyer signs if those are correct. The lawyer may then add any additional comments. The second type is a letter in which the auditor asks that the lawyer write, in letter form, all of the possible contingencies that the client faces. Typically, the first letter type is used since the lawyer may be agitated
by the auditor’s request for the lawyer to write a complete, detailed report of environmental and legal issues.

In this capacity, the lawyer is like a specialist. The auditor makes this request in order to become more informed of the nature of the existing or potential liabilities. As a result, the auditor’s judgments of the conformity of the financial statements is more complete, thus, reducing liability risk.

However, the lawyer may appropriately limit the response to auditor inquiries in one of two ways [SAS 12, AICPA, 1976]. First, the matters discussed are only related to material items of the financial statements. Second, the matters discussed have required substantial attention by the attorney in the form of legal consultation or representation. Consequently, the limitations due to the client confidentiality clause that are imposed on the responses could severely limit the scope of the audit enough to warrant an unqualified opinion.

The lawyer’s decision to limit the inquiry responses is not completely unknown by the auditor. Prior to inquiry, the auditor and the attorney make agreements about the use of the inquiry and the definition of materiality to use in responding to the inquiry. The lawyer has the responsibility to determine the material importance and seriousness of specified matters and the legal effects of non-disclosure.

For example, if a contingent liability potentially exists, the auditor has the obligation to obtain additional information about the liability to satisfy evidential matter requirements sufficiently. Thus, the auditor can contact the lawyer to help
determine the remoteness or probability of an event occurring in the future and the amount of the potential liabilities. From the information received, the auditor could then determine if the client should disclose the material on the face of the financial statements or in the accompanying notes. Regardless to the use of the lawyer inquiry, lawyer’s letters could provide essential evidential matter that the auditor pursued an issue completely before the release of an opinion.

Audit of Accounting Estimates

Under SAS 57, the auditors should base their opinions of accounting estimates on subjective and objective reasoning [AICPA, 1988]. The auditor is responsible for evaluating the reasonableness of estimates using professional skepticism. To corroborate management’s estimates, the auditor should perform a three step process. First, the auditor should review management’s process of estimating. Second, the auditor should reperform management’s process to test for correct procedures. Third, the auditor should review subsequent events or transactions that are affected by the estimate before the completion of fieldwork.

Full Documentation of the Audit Findings

When auditors enter an audit engagement, they must document their findings in a series of working papers and supporting schedules, as required by the standards [SAS 41, AICPA, 1982]. A majority of the work that auditors perform never enters into the opinion statement that accompanies the financial statements. However, if the
auditors are sued for their actions during the audit, the working papers and the supporting schedules could provide strong defense for due care and sufficient planning issues in a lawsuit.

Communication With the Audit Committee

The audit committee is responsible for overseeing the financial reporting and disclosure process of the client. During the audit, the auditors report the audit findings to the audit committee either orally or in writing. This communication is usually executed orally and then followed up through written documentation of the proceedings. The following items should be disclosed during the communication: the audit findings, the auditor's responsibility to report the findings, changes, management's judgments regarding estimates, and significant audit adjustments that could individually or in the aggregate affect the client's financial reporting process.

When reporting to the audit committee, the auditors may suggest changes that should be made to the financial statement that could affect their opinion of the statements once the engagement is complete. It should be stressed that the auditor is not responsible for the financial statement representations; this job is the responsibility of management. This segregation of responsibilities between management and the auditor would be made abundantly clear in the engagement letter (if it is used).
After the Audit Engagement

Retention of Audit Information

Upon completing the audit engagement, the auditor should retain files of the client’s working papers. Retention of the audit information provides documentation of the completeness and competence of the auditor’s work throughout the audit process. The auditor’s protection against liability in a lawsuit could rely heavily upon the adequacy and extensiveness of the documentation of the audit findings and management’s response to the findings. For example, the auditor should report suggested changes to the financial statements to the client. If the client refuses to make the required disclosures, the auditor should notify the board of directors and contact legal counsel. If changes are not made, the auditor has full documentation of the results if proper records are maintained in the working papers.

Response to Subsequent Events

Auditors are not required to make inquiries or perform subsequent event procedures after the opinion is released, except for filings under federal securities statutes. However, if the auditor becomes aware of subsequent events that, if known during the audit, would have been further investigated and the results affect the auditor’s report, the auditor should explore these events.

First, the events should be investigated and reported to the client to determine whether the information is reliable and existed at the date of the auditor’s report.
Next, the auditor must determine the significance of the findings to the financial statement users. The discovered information, if it is reliable, should be precise and factual "without speculation on the conduct or motives of the client" [Spellmire, Baliga, and Winiarski, 3.71]. Thus, the auditor should be completely objective, not prejudiced or accusing, when investigating the subsequent event. If the auditor approaches the problem by accusing the client of being intentionally misleading, the auditor could risk losing the client or could be accused of slander in a liability suit.

However, the auditor should pursue the problem carefully and methodically when deciding to disclose the findings. If the report is being used for immediate and significant purposes (i.e., for loan purposes), the auditor should issue revised financial statements and auditor’s report. If the subsequent event poses no threat to financial statement users, the auditor may elect to disclose the revisions in later financial statements and auditor’s report. The auditor could also notify known third parties that rely or are likely to use the financial statements or the auditor’s opinion.

If the information is reliable but the impact of the information is not determinable, and the financial statements would be misleading and the report should not be relied on, the auditor is not required to disclose detailed information about the matter. The auditor can, with certain discretion, disclose the information. If the client does not wish to cooperate and make changes, the auditor can opt to separate the report from the financial statements and indicate a desire that the report should not be associated with the financial statements.
During the Auditor's Career

Continuing Professional Education (CPE)

Auditing the environment is a new issue that requires special attention. Therefore, the auditors should make it their duty to become as knowledgeable as they can to limit legal liability during audit engagements. Although it is not readily feasible at this time to structure CPE courses about environmental issues, competent auditors should take it upon themselves to explore the literature that has been published by other professionals regarding this pertinent issue. Professionals, regardless of their career field, have a legitimate obligation to their clients and customers to have current, up-to-date information at hand. After all, their future may depend on it.

Withdrawal From the Engagement

One of the most extreme cases of minimizing the auditor's liability risk would be to withdraw from the engagement entirely. This action may be prompted by the client's intentional distortion of financial results or the client refuses to correct known errors and irregularities noted during the audit. However, withdrawal raises questions concerning loyalty to the client and to the auditor's firm.

Client loyalty may be violated if the client is relying on the auditor's report to obtain a substantial loan for a new project. If the auditing firm withdraws its services before completing the audit, a high probability exists that the client will not employ
the firm in the future. The client may further damage the firm’s reputation by relaying the news of the withdrawal to the auditing firm’s competitors and other firms seeking the services of auditing firms.

However, the auditing firm may be protecting its own interests when it withdraws from an engagement. The auditing firm is eventually responsible to the public, particularly investors and shareholders of public companies, for its actions. If the firm withdraws its services only to protect its interest, it is encouraged to seek consultation with legal counsel skilled in defending accountants’ professional liability claims. If the auditing firm is adequately able to defend itself against pending litigation, then the damages could be minimal.

As auditing environmentally influenced financial statements receives more attention, the profession should explore its duties and responsibilities to both the client and the public. Auditors must answer the question "where are the lines drawn that influence our decision to continue or quit the audit?" When the audit fails, the auditors place themselves at the mercy of the public for unintentional oversights. Withdrawal from the audit should typically occur only when independence is not established, not for the intentional misrepresentation by the client. However, the auditors should make a critical decision to withdraw from the engagement if the misrepresentation and lack of management’s cooperation causes a scope limitation.
ANALYSIS OF THE ISSUES

Auditing financial statements with environmental concerns is a relatively new area in accounting. Like most new things, this type of auditing imposes potential threats to the legal liability of the auditor and new responsibilities to fulfill. Currently, no formal or explicitly informative standards exist concerning environmentally influenced financial statements. Consequently, auditors must rely heavily upon loose interpretation and application of existing standards to complete their duties as professionals successfully. To assess contingent liabilities for future environmental clean-up costs, for example, the accountant obtains guidance from FASB No. 5 "Accounting for Contingencies." However, the question is raised "How is accounting for environmental clean-up costs any different from accounting for contingencies in other industries?" The following discussion highlights some of the reasons why the AICPA and other accounting bodies should further explore the auditing of environmentally impacted financial statements.

With the advent of federal regulations such as RCRA, the Clean Air Act Amendments of 1990, and CERCLA, more constraints are placed on industrial companies. As a result, the financial statements require extensive disclosure and documentation of environmental liabilities and costs. The auditor could become potentially liable for not detecting the proper disclosure of contingent liabilities. This threat of liability is particularly evident in CERCLA because it assigns liability strictly
and jointly. Also, the law extends the liability to parties other than the ones directly involved in the clean up of contaminated sites.

When auditors assess the compliance of financial statements with existing generally accepted accounting principles, they are placing their reputations and integrity on the line. Agreeing with Bewley, auditors could unintentionally misrepresent themselves if they try to assess environmental matters that are beyond their traditional knowledge and expertise. One of the only remedies for this problem is to seek the help of specialists such as environmental engineers and lawyers. However, given the limited time constraints placed upon the audit, auditors attempt to gather as much information as possible to provide substantial evidential matter to support their opinion of the state of the financial statements. Consequently, the auditors may overlook minute, yet important, details that could severely affect the statements compliance with GAAP. Thus, the auditors may become defendants in a lawsuit presented against the client if such errors are not detected.

What about the auditor’s duty to detect errors and irregularities? The auditor should design the audit so that tests of controls and tests of transactions would provide sufficient information about management’s representations in the financial statements. Under the code of ethics, the auditor is bound to perform the audit with professional duty of care. SASs nos. 53 and 54 guide the auditor in the procedures that should be taken to investigate any errors, irregularities, and illegal acts that arise during the audit. However, neither the code of ethics nor the SASs provide clear guidance to the
auditor in designing the audit to detect these problems. As a result, the public may accuse the auditor of negligence for not detecting errors, irregularities, and illegal acts through the course of the audit. However, the public does not realize that the auditor cannot be responsible or negligent for matters that remain undiscovered if the audit was carefully planned and performed. The auditor would be correctly blameworthy if the matter is discovered and the auditor did not pursue the issue further. Simply, the auditor could become illogically liable for management's neglect to anticipate contingent liabilities if the auditor does not have the available guidance to plan and execute the audit program.

When the auditor performs duties in conformity with generally accepted auditing standards and the professional code of ethics, the public may still incorrectly hold the auditor responsible for losses that result from using financial statements that were incorrectly assessed. The public, therefore, expects the auditor to perform duties with its concerns in mind. In attempt to narrow this expectation gap, the AICPA has considered the possibility of additional specializations within the profession. In the article written by Shambo and Eveloff, discussions for and against specialization are presented.

Shambo's pro views are very valid and can be substantiated. With accreditation, auditors of environmentally influenced financial statements could improve their reputations, integrity, and competence. By seeking accreditation and obtaining more training in environmental issues, auditors may substantially minimize
their exposure to subsequent liability. Furthermore, since the AICPA has been allowed by the government to regulate itself, implementing an accreditation program for the environmental auditor would reinforce the public's confidence in the AICPA's attempt to increase its responsibility to society. Allowing accreditation to occur would substantially promote the best performance out of the accountants as well as provide a means to become increasingly aware of the issues accountants must face.

Eveloff suggests that specialization would be very costly. This fact cannot be denied. However, he does not consider the benefit of specialization to protect the auditor from potential liability. If auditors begin an engagement with little knowledge of the environmental issues, the risk of lawsuits is increased if environmental concerns surface. However, Eveloff would probably argue that the purpose of lawyers and other specialists is to help the auditor understand environmental matters that arise during the audit. With increased knowledge of potential environmental issues that could affect the client's financial statements, aside from information obtained through the inquiries of experts, the auditor would substantially increase professional competency and reduce liability.

Eveloff challenges the notion that accreditation would be a means for monitoring and improving practice quality. While peer review, as he suggests, is one way of achieving these goals, it cannot possibly be expected to help the auditor become more aware of the knowledge of environmental laws and regulations that
affect financial statements. Therefore, it is suggested that specialization would be in order.

While Shambo’s opinion of specialization is admirable, those who support his view may claim that specialization is not very feasible at this time. First, there has been no formal investigation of the environmental issues that the profession currently faces. Second, without knowledge of environmentally specific standards or at least environmental interpretations of existing standards, the AICPA cannot reasonably be expected to begin planning a program. The AICPA must learn how to crawl before it can walk. It must determine what issues need to be addressed before it can design a program for additional specialization. Third, an implementation of new programs may not be prudent at this time. The AICPA must attempt to make the public more aware of the auditor’s responsibilities to the public to close the expectation gap. In 1988, the AICPA attempted to close the gap by releasing SAS nos. 53 through 61 which provided further audit guidance in the form of working papers, lawyer’s letters, and responsibility to detect errors, irregularities, and illegal acts. However, the public and even the courts (as noted by O’Malley) tend to mistakenly associate the auditor’s duties during an audit with the detection of fraud. The auditor’s primary responsibility is to determine if the financial statements are in compliance with GAAP. If questionable areas arise during the audit, the auditor should thoroughly explore the findings until sufficient evidential matter is obtained. In the future, once the public is
informed of the auditor's responsibilities when performing the audit, the possibility of specialization will be greater.

While specialization may be a solution to the problem of auditor liability, it cannot be ignored that auditors have a responsibility to provide reasonable assurance for reliance on the fairness of the financial statements [SAS 58, AICPA, 1988]. If the audit report fails to provide the public with the assurance that it needs, then society may allege that the auditors are not doing their jobs. However, what the public does not realize is the fact that the rate of alleged audit failures involving U.S. publicly held companies is less than one-half of 1% [Chenok, 47]. The public reads the newspaper and listens to the television news reports that another audit failed to achieve its objective. What the public needs to hear more is that the audits that are successful exceed 99%. However, it seems that no one wants to focus on the fact that something actually works in our society. Instead, we only want to find out what is wrong and attempt to fix it or grossly distort the true impact of the situation, thus creating severe skepticism of our methods.

However, the auditor can help to alleviate some of this skepticism. By utilizing a utilitarian approach to analytical procedures during the audit, the auditor could possibly be able to consider the main concerns of the client, the stakeholders, and the auditing firm itself. Under utilitarianism, a person attempts to evaluate all of the benefits and costs of certain actions [Velasquez, 61]. Once the benefits and costs of each alternative are weighed against each other, the person then chooses the
alternative that provides the greatest net benefit to the most people. This ideal fits in well with the auditor's approach to audit proceedings. For example, deciding whether or not to account for emissions allowances as inventory or as a marketable security requires that the auditor consider the consequences of accounting for them under each method. Another example would be the auditor's choice to interpret accounting principles in such a way as to comply with the profession's expectations while considering what the client interprets to be the correct way to apply a certain accounting method.

According to Velasquez, the theories of contract, due care, and social costs would aid in the analysis of the source of and responsibility for liability. These theories would attempt to assign the responsibility for the failure to disclose contingent environmental liabilities to the appropriate parties.

Under the contract theory, two parties enter into an agreement in exchange for goods and services [Velasquez, 275-276]. The auditor agrees to attest to the fairness of the financial statements in exchange for a fee. However, what is the auditor to do if the client and its lawyer intentionally withhold information regarding a contingent environmental liability that should appropriately be disclosed in the financial statements? If auditors discover the liability before completing the audit, they can simply withdraw from the engagement by reason of scope limitation. However, if the auditors do not discover the disclosure until after the report is released and used by investors and creditors, then the auditor may have to unfairly pay a penalty. By this
time, the auditor would have very little recourse except to bear the costs. Regardless, the auditors should not have to incur the liability if they can sufficiently prove that they had no previous knowledge of the contingency and can reasonably prove that the contingency was not significant enough to warrant disclosure in the financial statements.

Under the due care theory, the stockholders and investors would have the right to moral recourse for the auditor’s failure to persuade the client to disclose information about its additional findings [Velasquez, 287]. Thus, the duty of care would also be extended to the client as well. If this theory holds true, the auditor would be forced to compensate those parties harmed by the non-disclosure. However, if the undisclosed information resulted from using the work of a lawyer or a specialist, would the auditor be able to minimize liability? Per the exposure draft of "Using the Work of a Specialist," the auditor has the obligation to investigate the qualifications of the specialist and to follow up on the information received from the specialist [AICPA, 1993]. However, if the auditor appropriately explores the findings, the liability should also be shared by the specialist.

Under the social costs theory, the party that incurs the additional liability has the right to add this cost to the price of its product [Velasquez, 290]. Industries that incur environmental clean-up costs can very easily incorporate the cost of the clean-up in future products. This increase in the cost can easily be justified. However, if auditors incur liabilities for failing to persuade the client to make changes to the
financial statements, their liability insurance increases and, eventually, they increase their fees. For example, if a small or medium sized accounting firm has to pay $1 million for an environmentally related lawsuit, they might have to increase their fees to make up for the loss and risk the possibility of losing clients to other firms. Furthermore, this increase in fees could be unfair to the client who must either bear the costs or spend time and money to retain another auditing firm.

To decrease the liability possible under these theories, auditors should have access to additional training via continuing professional education. While specialization is not feasible at this time, auditors should take existing precautions and procedures that are suggested by the standards and incorporate them into their work. However, in the near future, the AICPA and other accounting bodies should thoroughly consider further exploration into this new area of accounting to help auditors minimize the risk of liability and maintain reasonable insurance premiums.

**CONCLUDING COMMENTS**

The issues that the auditor of environmentally influenced financial statements must face today are varied. First of all, auditors must confront the pressures of meeting the stringent expectations of the public as they release their opinions to the public. Furthermore, the expectations of the client and its immediate needs for the attestation of the financial statements. Second, auditors must meet the expectations of the client and its professional and personal goals. Third, and most importantly, auditors must achieve the expectations of their chosen professional and institutional groups.
maintain a certain degree of competence and professional integrity. In order to meet all of these expectations, auditors must have access to the proper guidance that will tremendously help in their analysis of environmentally influenced financial statements. Currently, the professional standards have been able to provide minimal support for auditing the environment.

While accreditation of new specializations may not be very feasible at this time, more traditional procedures, as suggested by recent SASs and professional standards, may help auditors make the transition into this new area of accounting easier. These procedures might also help them fulfill their new responsibilities and roles that are imposed upon them by clients and the general public. These procedures, such as engagement letters, adequate inquiries of clients and specialists, and more complete documentation, also serve to minimize liability once the audit is complete.

However, whatever measures the auditor takes during the audit to lessen the risk of audit failure and liability for the disclosure in the financial statements, the public should be made abundantly knowledgeable of the auditors true responsibilities during the audit. The public generally tends to think that the auditor's sole duty when accepting the audit is to detect fraud and find errors. However, the profession should make a concerted effort to explain to the public that the audit program is specifically designed to provide evidential matter to warrant the auditor able to opine, via the auditor's report, with reasonable assurance that the financial statements are fairly presented. Furthermore, with additional financial statement disclosure, on the part of
management, the public might become more aware of the separate duties and responsibilities that the management and the auditing firm assume with regard to the content of the financial statements. Management is responsible for the content and the auditor is responsible for attesting that the statements are fairly presented with respect to generally accepted accounting principles.

The AICPA and other accounting bodies should now accept a new perspective on the perceived importance of this new area of accounting. These bodies should make a concerted effort to explore these new issues and solicit the concerns of fellow professionals. If the release of new, specialized accounting standards is not practical at this time, then the release of a discussion memorandum may be acceptable. Continuing professional education courses containing tips, precautions (such as Specht's environmental red flags), and information about auditing environmentally influenced financial statements should also be available. These courses should be taken at the auditor's discretion to fulfill their new expectations as well as to meet CPA requirements. These courses would help auditors minimize their risk to liability for simply not have adequate knowledge. In addition, the laws and regulations set forth by state and federal governments should be readily available to the auditors so they can become more aware of the issues that they are confronting. Regardless of the means taken, the profession, and the public as well, needs to be made aware of the added expectations of the auditor in the area of auditing financial statements with environmental concerns.
BIBLIOGRAPHY


