

The Effect of Auditor Involvement with Projected Financial Statements on Loan Officers' Lending Decisions for Start-Up Companies

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Forensic accountants are charged with identifying and understanding key risk areas when providing legal and investigative support. In the U.S., the advent of the Private Securities Litigation Reform Act of 1995 highlighted the importance of auditor involvement with forward-looking financial statements because of the riskiness and exposure associated with such speculative statements. This study investigates how different levels of auditor involvement with projected financial statements affects loan officers' lending decisions for high risk start-up companies. We hypothesize that increased auditor involvement will lead to greater reliance on the auditor as measured by the perceived accuracy and achievability of projected statements, the likelihood of granting a loan, and the obtainment of an acceptable interest rate for the start-up entity. Using a between-group design with three auditor involvement treatments (i.e., no involvement, compilation, and examination), 62 commercial loan officers completed the experimental materials. The results indicate that auditor involvement was associated with increases in both perceived accuracy and achievability of the financial projections. However, the extent of auditor involvement did not make a difference. Further, higher auditor involvement resulted in a greater likelihood of the loan being granted. We discuss the findings in the context of emerging audit and financial lending policy and practice, as well as in the context of emerging forensic accounting responsibilities.

INTRODUCTION

“Because forward-looking disclosures have been the subject of abusive claims, issuers have been unwilling to make them and auditors have been unwilling to risk association with them” (Andrews & Simonetti 1996, p. 54).

The practice of providing forward-looking financial information has generated great interest among auditors, regulators, and investigators because it is ripe for fraud and misunderstanding among stakeholders. The Private Securities Litigation Reform Act of 1995 was passed in part to address these problems and represents an important step in U.S. tort reform.