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Discussant's Response to A Multi-Attribute Model for Audit Evaluation

Joseph X. Loftus

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The ability to objectively determine the quality of an audit engagement has thus far eluded accounting firms and others interested in auditing. It has been suggested that if the annual report does not contain any typos, the auditor is not sued, obtains full realization of fees and is reappointed, the audit, at least in the eyes of the auditor, is of high quality. That assessment is somewhat cynical. Ted Mock and Michael Samet in their paper bring to bear a much more reasonable approach for determining a meaningful measure of the quality of an audit.

I concur with the authors that multi-attribute evaluation (MAE) provides a framework for evaluative analysis. However, I submit it is only a framework. Any evaluation analysis—any attempt to conclude as to quality—ultimately rests on the judgments, subjective judgments, of the evaluator. Yes, there are exceptions. We would all agree that the more famous auditing busts over the years were indeed audits with major problems. We have all reviewed audit workpapers which under any test would support calling the audit “excellent.” Most audits would fall within the extremes and it is here that subjective elements are important. KNOW THY RATER is crucial in analyzing any results of any evaluation, whether it be the evaluation of an audit, evaluation of personnel or an evaluation of an auditing textbook.

Peer Review Experience

To date, the peer review committee of the AICPA SEC Practice Section has reviewed and accepted some 400 peer review reports. The objective of a peer review is to determine whether the quality control system of a firm met the objectives of the AICPA quality control standards and was being complied with so as to provide the firm with reasonable assurance of conforming with professional standards. Crucial to any such determination is the review of the firm's auditing and accounting engagements. As a result of the review, the reviewers issue a report and, if they note matters which would result in substantial improvement in the reviewed firm's quality control policies or procedures, the reviewers issue a letter of comments. The most difficult problem confronting the peer review committee is the unevenness of reporting resulting from this process. Some reviewers will consider an item so serious as to cause a modified report, while others, confronted with the identical situation, would issue an unqualified report but mention this matter in the letter of comments. We had our first peer review under the aegis of the SEC Practice Section in 1978. We have tinkered with the process ever since in a futile

attempt to resolve the “unevenness” problem. We have one consolation—the profession has been trying for a substantially longer time to define materiality.

The Mock/Samet AQE Form

The Audit Quality Evaluation form developed by Ted and his co-author would minimize the subjective element inherent in an evaluation process. It is certainly a vast improvement over the approaches currently in vogue. For example, after reviewing a set of audit or accounting workpapers a peer reviewer is asked to conclude with respect to two broad questions—whether he believed that (1) the firm had a “reasonable basis under professional standards for the opinion it expressed” and (2) the financial statements conformed with generally accepted accounting principles.

As to the methodology, I certainly have no quibble with the methodology followed by the authors in developing the AQE form. Indeed, I’m impressed. However, in the classical auditor’s fashion, I must hedge by pointing out I’m not an expert in developing or testing a multi-attribute evaluation model. Nevertheless, the major categories—Plan, Administration, etc. seem appropriate as do the attributes and questions within the individual categories.

Allow me one personal bias in regard to the form itself. My limited experience indicates that forcing an evaluator to conclude “yes” or “no” to a given question is generally better than allowing a “yes but” or a “yes, except for.” Too often evaluators use the “yes, except” option as an escape from making a hard, perhaps distasteful, call. The “except for” can be so overwhelming, so significant, that it negates the yes answer and the reviewer of the form is left to make the judgment as to whether the true answer is “yes” or “no.”

The accommodation in the form to allow a conclusion on the sufficiency of audit documentation is a sound idea. In the peer review process, we have been plagued by the lack of documentation of key audit judgments. The lack of adequate documentation is the most frequent weakness found in a review. An observation that documentation is inadequate leads to the obvious question as to whether the work was really performed. In some cases, corroborating evidence is available. In other cases, one wonders. A quick review of a compendium of peer review comments compiled from letters of comments accepted by the SECPS peer review committee during the nine-month period ended in March 1982 indicates well over half of the comments are connected with the question of documentation. As a result of the findings of the peer review process, both the Auditing Standards Board and the Quality Control Standards Committee of the AICPA have issued guidance in the area of documentation. The ASB recently issued SAS No. 41 entitled *Working Papers*. The Quality Control Committee issued an interpretation in April specifying the level of documentation required for the nine elements of quality control enumerated in Statement on Quality Controls No. 1. For example, among the reports accepted at the peer review meeting earlier this week was a report and letter of comments covering a peer review of one of the larger firms. All of the matters noted in the letter of comments related to documentation:

- The firm should document procedures followed in resolving independence questions;

- The following areas were not adequately documented in accordance with firm policies:
 - Auditing procedures followed in the areas of related party transactions;
 - Procedures performed in connection with the acceptance of new clients and the decision to retain existing clients;
 - Disagreements with clients and resolution thereof;
 - Procedures performed between balance sheet date and report date.
- Firm policy should be amended to provide guidelines for the extent of audit consultation and the related documentation;
- Document the evaluation of the adequacy of the client's internal controls, including EDP controls.

It would be interesting to see how evaluators using the AQE form will react to the documentation questions.

To wrap up this part of the discussion, I agree with the authors that research efforts should continue in this area. The AQE has the potential for being a useful technique in evaluating an audit. The technique also has potential in other areas of concern to auditors, for example, promotion of staff to partner. The authors have developed a tool which could be of benefit to auditors and the users of their product.