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Recommended Citation

Auditing Symposium IX: Proceedings of the 1988 Touche Ross/University of Kansas Symposium on Auditing Problems, pp. 115-117;

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Discussant's Response to "Auditor Evidential Planning Judgments"

Robert H. Temkin

Arthur Young & Co.

It is indeed an honor for me to participate in this symposium as a discussant and a special pleasure to follow Professor Wright. Dr. Wright is Harold A. Mock Professor at The Northeastern University, which is, of course, located in Boston, my once and, I'm glad to say, future home.

Harold Mock was the managing partner of the Boston office of Arthur Young when I joined the firm in 1964. He was the consummate professional, an astute manager, a superb technician, and a man of the greatest personal and professional integrity. He was very good to this junior auditor and I remember him with great affection. It is good to see the professorship that carries Harold's name in the hands of so distinguished an academician.

This is my first experience as a discussant at an academic conference, so I have chosen to approach this assignment in a manner similar to that of a concurring partner on an audit, something with which I am familiar. As a result, however, my remarks focus more on the problems I had with the paper and the case study rather than on the good things accomplished and presented by the researchers in the paper. Actually, I really want to talk about only a few things related to this case study and paper. I want to discuss some possible causes of the results as well as the conclusions of the research.

Designing a case study to deal with as complex a matter as an inventory audit is a difficult task and Drs. Wright and Mock have done an excellent job. Nonetheless, the information is not, and probably could not be, complete. Accordingly, the auditor must answer a number of questions on his or her own, and these questions are not unimportant.

For example, why does a client with perpetual records and strong controls take a physical inventory every year? What has been the experience with the physical inventory? Are "book to physical" differences common or uncommon? How reliable are the perpetual records? How often are they reconciled to the financial records? Further, the case study does not address in detail how the physical inventory is to be compiled and priced, or provide the ability, except intuitively, to assess the risk of errors in compiling the inventory, errors in extension or footing, or the risk in incorrect prices being used. The auditor also needs to guess, in this case, how labor and overhead are applied to the inventory and whether the case includes auditing these components of the inventory.

As I said, the case study is excellent. If all the information were to be provided, the case would be unreadable. Nonetheless, when auditors need to make assumptions about the risks of certain types of errors (stated otherwise, about certain financial statement assertions), the auditors will, of course, differ and produce different audit approaches.

The Arthur Young audit decision support program, which has been in our practice for two years, contains numerous questions to help the auditor decide how to approach the determination of inventory quantities, from the purpose of the physical inventory to an assessment of risk of error in compiling, pricing and valuing the inventory. In fact, we approach a physical inventory as a "non-routine data process," our term for an activity that has many of the same attributes as a routine data processing activity, but that happens relatively infrequently. As a further complication, the audit program for inventory that is included in the case does not contain procedures that would appear to address the "net valuation" assertion.

Auditors would, in completing the case, have to either not approach that assertion or use one of the procedures provided to deal with the valuation assertion. The resultant audit programs could very well be very different.

I cannot resist talking about the 150 hour budget provided in the case for the audit. We CPAs in public practice are continually criticized for over-emphasizing budgets, and letting the budget dictate the procedures. Now I don't know whether the participants viewed 150 hours as a lot of, or a little, time to audit the inventories in the case study, but their view of the 150 hours would necessarily influence the procedures, and how the time is allocated. Would the allocation have been different if a fixed time budget had not been provided? I expect it would.

Of course, the lack of consensus in the procedures applied was predictable when considered with the inconsistent and inconclusive results of the pairwise comparisons of auditing procedures. Look at the difference between the views of the sufficiency of evidence provided by analytical procedures as opposed to observation and detailed tests! In one group, 82 percent believed that analytical review provided more sufficient evidence than detailed tests, while in the other group 80 percent believed detailed tests better met the sufficiency criterion. Now, how could something like that happen?

The fact is that all auditors solve planning problems and approach planning based on their education and their experience. Over the years, we pick up biases as a result of what we've been taught and our experience in other client situations. It's no secret that firms differ in their view of the usefulness of analytical review procedures. Some firms place great weight on the results of analytical review in deciding whether they have sufficient competent evidential matter, others will not. Of course, in almost every case the answer is situationally determined, depending on the risk of error and the results of the analytical review.

It is also interesting to note that there is no consensus of view between observation and detailed tests as to competence and sufficiency. This probably results from auditors' inability to check "it depends" on the account and the assertion; how somebody views this problem will also depend on the column in which one puts confirmation. However, I want to take the most issue with the authors' conclusion that the divergent allocation of audit hours among procedures is disturbing, since such widely varying audit plans suggest that engagements in practice may differ substantially in efficiency and/or effectiveness. While I agree that further refinement of a multi-attribute method such as Analytical Hierarchy Process may lead to greater consensus, I cannot agree that lack of consensus is necessarily bad.

In 1983, we at Arthur Young began the development of an expert system for audit planning as part of what has become known as AY/ASQ. The result is that AY/Decision Support has been in general use in our firm since 1986, and has been joined by a version tailored to the banking and thrift industries. In developing AY/DS, we had to address up front precisely what our objective would be. And while improved consistency was an objective, it was much less important than improved efficiency and better correlation of substantive procedures to the assessment of risk, especially control risk. Auditors need to feel free to develop an audit approach that they believe will be responsive to the needs of the particular audit engagement. We must recognize that engagement needs are driven not only by the characteristics of the account (or client) being audited, but by factors such as availability of evidence, reporting deadlines, and the people available to do the work.

For example, we might agree that application of analytical review procedures as substantive tests is enhanced if the person applying the procedures has more experience, in general, and more experience with the client and its industry, in particular. I submit that there is more than one audit approach in almost every situation that will produce an acceptable audit; that is, one that will reduce audit risk to an acceptable level, assuming, of course, that we could agree on that acceptable level of risk. So then, why worry if research confirms that different auditors would pick different approaches? After all, who cares which road the auditor takes, as long as the auditor arrives at his destination? It is also possible that there is more than one approach that is effective and is also efficient. In the case study, each auditor presumably believed that he or she had arrived at an effective audit approach that could be completed in 150 hours!

The Talmud states that there is more than one way to righteousness, and that each man must choose his own path. So it is for the auditor who sets out to do the best audit. He must choose his own path based on his knowledge, his experience, and the needs of the engagement. Of course, in the real world, his views will be subject to, and be tempered by, the review of others, generally with more experience. This review tends to have a leveling effect, bringing somewhat more consistency to audit plans.

This does not mean that audit planning is not a fertile ground for ongoing research. As the authors indicate, there is much that can be done in addressing how auditors relate procedures picked for one objective when considering approaches for other objectives. We can also consider further how auditors begin the planning process—the “jumping off point.” In developing AY/Decision Support, we quickly learned that there were, for most accounts, certain procedures (for example, confirmation of receivables) that auditors almost always use, and often serve as the principal source of assurance for the data related assertions. When the auditor assesses control risk as low, and has tested controls accordingly, these principal procedures may be all the substantive procedures required for the data-related assertions.

This type of research can be invaluable not only in developing decision aids but also in helping train the auditors of tomorrow. We have much to learn about how audit judgments are made. Drs. Wright and Mock have moved this process ahead; their principal contribution, however, may be in giving us a way to go still further.