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Discussant's Response to Let's Change GAAS!!! ??? * &# @

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Periodic reevaluation and reexamination of all aspects of our professional environment constitute an excellent idea. The authors of this paper are to be complimented on their efforts to take ill-formed feelings of dissatisfaction with current Generally Accepted Auditing Standards, identify a need for change, and develop a response that should provide all of us here today a chance to think and to argue about the changes to Generally Accepted Auditing Standards are currently appropriate. I do agree, in general, with their argument that Generally Accepted Auditing Standards need reevaluation and probably need change.

General Observations

I also have two rather strong reservations on the content of their paper which I will try to support with some of my more detailed comments later on. There is considerable unevenness in the presentation in this paper, and many of its views and positions are, at best, weakly supported. It is very distracting to try to agree with a paper and the arguments in it when many of these arguments are poorly supported. In addition, for a paper that is proposing basic modifications to the conceptual criteria for professional auditing, there is very little theory. In particular, I would like to have seen a careful identification of the appropriate level and content of overall standards; that is, a thorough discussion of the level of concept at which GAAS should exist. In addition, a systematic argument from this concept or theoretical framework as to what the specific standards ought to comprise is needed.

For example, there is no definition of the term "attestation." A well-thought-out definition that leads one to some of the constructs underlying this service to society would seem essential. I usually think of "attestation" in terms of third party assurance on the "quality" of reasonably objective economic information. I would argue that "quality" criteria that would provide a framework against which auditors could evaluate their performance should, as the authors point out in a place or two, be established at a high level. Detailed content specifying specific actions or lack of action should be avoided and deferred to later interpretations of the basic criteria promulgated by the appropriate senior committee of the AICPA. The definition given above would suggest that the overall criteria ought to include a description of acceptable third parties, general criteria for the process of forming a level of assurance, reporting criteria, and possibly, although debatably, other criteria. After developing such a setting, the paper could then move on to proposing specific standards and to comparing them with existing GAAS in a logically coherent fashion.

As an aside, I found the authors a bit harsh in their implicit evaluation of the Auditing Standards Board. They seemed to suggest that, in setting standards for historical financial statements, the Auditing Standards Board is very faithful in following GAAS. On the contrary, when setting standards for services other than audits of historical financial statements, the Auditing Standards Board is pictured as charging off in all directions with very little discipline or careful thought. I think neither extreme is accurate. One could hardly consider the Auditing Standards Board as faithfully following GAAS when, in fact, they are modifying GAAS in particular SASs. For example, a change in the second field work standard is included in SAS 43. On the other hand, in setting standards for internal control reports in SAS 30, one could argue that the Auditing Standards Board was reasonably consistent, at least with the spirit of GAAS in establishing both field work and reporting guidance for this type of service.

Some Detailed Comments

The introduction to this paper seems intended to create a splash. But it is not clear to me that the changes proposed in this paper are really so dramatic. The proposed standards seem quite consistent with what I would view as the spirit of the original GAAS, and, in fact, later on in the paper, the authors explicitly state that they are going to follow the framework of GAAS. Also, in their zeal to present a strong case for their proposed modifications, the authors seem to overdo their arguments. For example, note the logic in the opening pages. The proposition here is that GAAS “no longer provide sufficient foundation for guidance. . . .” In support for this proposition, the authors indicate that GAAS are old (36-years old), that they are designed for audits of historical financial statements, that they are restricted to these financial statements because they are specifically mentioned in the standards, that practice at the time involved only audits of historical financial statements, and that since GAAS were not intended for other service, it is illogical to conclude that they were intended or could be interpreted as applying to other services. These arguments do not support the premise. They do nothing to demonstrate that GAAS are, in any explicit sense, insufficient or inappropriate, other than that they make specific reference to one narrow type of service. The resulting standards that the authors develop may be reached by another argument. For example, consider the view that the current standards are “in spirit” a reasonable start. As mentioned above, the authors could use that framework and a “qualitative criteria” objective to reach the proposed standards.

A bit further on in the paper, the authors point out four problems: 1) that audit services exist for which there are no general quality criteria or standards, 2) that statements on auditing standards have been established “on the basis of inapplicable general standards,” 3) that statements of auditing standards for new services are inconsistent, and 4) that there is no guidance for future possible services. Let’s discuss each of these in sequence.

Concerning problem 1, the authors point out that GAAS do not restrict new services and that, as a result, new services beyond the boundaries of current GAAS have been offered purportedly without any authoritative guidance. Implicitly, they say, therefore, that new standards are necessary. Something is left out. Two logical links that occur to a reader are as follows. The authors are assuming 1) that no services should be offered without explicit or implicit

coverage in GAAS and 2) that no services should be offered beyond the boundaries of such established GAAS. Neither of these premises is supported.

In discussing problem 2, where they believe that SASs have been established on the basis of inapplicable general standards, they point out that new services exist that have no basis in statements in auditing standards and that other SASs supporting new services are of “questionable authority.” There seems to be underlying disposition, although not specifically stated and argued, that all SASs must be derived from GAAS rather directly as a matter of coherence and legality. This connection is mentioned in rule 202 but is not especially clear elsewhere in our professional literature. While it may be desirable, it would be of considerable interest to have the authors establish this point. Also, it is not clear why SASs for other services that are in some sense consistent with the underlying concepts in GAAS are of questionable authority. In any case, based on these rather ill-supported arguments, the authors conclude that new standards are necessary to legitimize Statements on Auditing Standards.

In discussing problem 3, where they argue that the SASs are inconsistent where not based on GAAS, they refer to inconsistencies, ambiguities, and fragmented professional requirements without illustration and then suggest that new standards would eliminate the problem. While I might agree that new standards may help, a part of the problem to which they refer may be due to other factors. For example, the abilities of the current board and auditing division staff or the effects of the political process on standard setting may be partial causes. In any case, the arguments for this problem are not convincing. There are no specific problems described, nor are the reasons that new PAS would eliminate (or reduce) the problem given.

In discussion problem 4—the need for guidance for future possible services—they point out that, since GAAS is limited to audits of historical financial statements, they are “impotent” as authoritative guidance for future services. Based on this assertion, they state that new standards are necessary. There is, again, no argument or evidence given to support their view, other than their assertion. Also, in this section, they point out that, if restrictions are desired on new services, new standards should establish such restrictions. There is no theory or argument given for the idea that future services should be restricted.

Arguments for Proposed Changes

In this section of the paper, the authors begin by pointing out that existing GAAS provide a valid model. Does this assertion suggest that there are concepts underlying GAAS that continue to be useful? I believe such to be the case. In fact, the argument here suggests that the previous positions are overdone. I would also like to take issue with the point that sufficient comprehensive standards must provide basic guidance. I am not sure what the authors mean by basic guidance, but I prefer the term “quality criteria,” since it is my view that guidance carries with it the connotation of specific rules and procedures for practitioners that are best left to Statements on Auditing Standards or other rule-making derived from the general standards being proposed.

In reviewing the authors' list of items that specifically should be covered by auditing standards, I am not clear whether or not the authors meant this list to be comprehensive, but it is not, since personal standards and most of the field work standards are omitted. The use of a list of imperatives suggests the need for a *complete* list leading to the proposed standards.

At this point in the paper, the authors raise the issue of whether or not we should call ourselves attesters or auditors. I have a bias towards retaining the term "auditor." It seems to me that the term is understood broadly by the general public and that there is no evidence that the general public restricts this term to audits of historical financial statements. Also, the term "auditor" is identified in statute and by the public, as a group who are expert at providing assurance.

Comments on Specific Standards

Let's look, first, at the proposed second general standard on competence. I found the term, "commanding competence," interesting. It seems to me that society's expectation should control here. That is, some degree of competence is likely to be required of and perceived by the public as residing with the auditor or attester, regardless of any standards we establish. This leaves me agreeing with the overall objective of the standard, but it is not clear how the objective should be achieved. Will the word "commanding competence" be understood? And is this standard really necessary, or might guidance better be given in SASs?

The third general standard also seems okay in concept, but it is also too detailed. I would leave for Statements on Auditing Standards the issues of clarity and consistency in estimation. Such issues are subject to changing social expectations and are better left to changeable interpretations of the basic standards.

The second field work standard includes discussion that goes far beyond that necessary to support the standard. The authors seem to have spent quite a bit of time agonizing over the appropriateness of the audit risk model included in SAS 47. I am not sure of the purpose of this discussion, but it is interesting to note that the concept of the risk model is logically consistent with the concept of assurance that is basic to the attest function. I was also somewhat disturbed by the discussion of a need for reasonably uniform assurance levels and the subsequent call for research. This discussion needs focus. It is very likely that auditors currently provide different levels assurance in audited financial statements. Is this bad, or is it even avoidable? I do not think so. Our problem is a lack of agreement on the definition and use of the term assurance. A better development of the idea of when and where assurance can vary and how the variation should be reported would seem more precise for this section.

Reporting standards 3 and 4 discussed toward the paper's end seem awfully detailed. Are they really needed? They sound like specific guidance rather than criteria for auditors in the long run.

An Overview

This paper is clearly well designed to provide us with the substance for a good discussion. The proposed standards, themselves, seem to be a good

effort but may include too much detail. The paper supporting these standards has too much of a flavor of a sales pitch and would have been much more effective if framed in concept and theory. In addition, the legal and political dimensions of the proposed changes are not made clearly in the paper and need much more discussion.