Discussant's response to the new AICPA Audit Commission -- Will the real questions please stand up?;

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The New AICPA Audit Commission—
Will the Real Questions Please Stand Up?

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One finds no argument with Mr. Harlan’s belief that establishment of the AICPA Audit Commission can be a positive step toward improvement in the world of auditing. However, as he implies, it is not merely the appointment that represents progress but rather the ultimate product of the Commission that finally must be perceived as relevant and meaningful. In order to attain these latter qualities not only must relevant and meaningful (i.e., real) questions and issues be raised, but they must be resolved to the satisfaction of the “worlds” that exist outside the world of auditing.

Other Worlds

Some view auditing as a very small sub-world in society and others view it as a universal, pervasive and larger world in its own right. Typical expressions of the various worlds, which auditing is both in and of, are couched in terms of the societal segments that are interested in financial communications.

In order not to belabor this old and familiar concern, let me just draw a picture in words: Visualize a series of concentric circles that represent various societal spheres of interest. In the inner circle lies accountancy, and in successively larger outer circles management, present stockholders, all other present investors, other economic interests (e.g., labor, competitors, suppliers), potential future investors, and other social-political interests (e.g., regulators, ecologists). In my mind’s eye, auditing is the set of spokes that connects these other worlds to accountancy, for better or for worse.

I wish to make two points based on the foregoing preamble: First, auditing is inextricably bound to accountancy in current thought, thus it is oftentimes difficult to distinguish an accounting question from an auditing question. (More on this point later.) Second, the length of the imaginary spokes is important to auditors in the context of specifying auditors’ role(s) in society. A closely allied corollary question in this regard is: “Who is the auditor’s client?”

I submit that the definition of “client” is more than a mere exercise in semantics. The definition lies at the heart of auditors’ acceptance of professional responsibility, and the issue constitutes the premier real question for the new audit commission. The AICPA Code of Ethics defines client as the person(s) or entity which retains an auditor for professional services. I perceive this definition as deficient because it does not fully recognize the social-political concerns of other worlds with whom an auditor has a social contract to fulfill.
Mr. Harlan has recognized this issue forthrightly in his own first question for the commission, and I am in full agreement with him. He has augmented his first question with his last one, raising the issue of the relationship between the auditor and the auditee. These two real questions are parts of the same issue, but they have been somewhat slighted in the reported charge to the Commission.

The Art of Raising Questions

Relevant and meaningful decision outputs cannot be attained unless the real questions are first identified. This assertion is a truism long recognized in a technical sense by practicing auditors as a matter of decision theory (viz., relevant evidence cannot be obtained unless first the relevant assertion, explicit or implicit, has been recognized and formulated as a decision problem). In the context of the charge to the Commission, questions are real only to the extent that they are relevant and meaningful to the “other worlds.” This does not preclude their being relevant and meaningful to auditors alone, but if they are limited to technical issues, then the other worlds will be disinterested and will perceive the Commission’s product as self-serving.

The essence of the art of raising questions about auditing, thus, is the art of making them meaningful to non-auditors. The other worlds, in my opinion, are interested in meta-conceptual questions and the philosophical impact of responses to them. Competing with this line of approach is the auditor’s need to pose operational questions which can be resolved in a manner amenable to “making things work.” As an expedient, the Commission charge could cloak the operational questions in a mantle of philosophy, but it has not been done in this manner.

Nevertheless, I believe that the Commission charge contains operational questions that correspond in part with Steve Harlan’s first and last question points. In order to be quite specific, I suggest that the following portions of the charge are consistent with real questions of auditor role and auditor-auditee relationships.

1. What responsibility should an auditor have for detecting fraud?
2. Should auditors monitor all financial information released to the public and, if so, what should be the extent of their responsibilities?
3. Should the auditor’s standard report, particularly the phrase “presents fairly,” be changed to express better the responsibilities of auditors?

In my perception of the social milieu, each of these questions will have to be answered in such a manner as to expand the responsibilities presently accepted by auditors to match the expectations of the social circles that lie beyond management. The other worlds will apparently perceive anything less as a recalcitrant and self-serving ploy to avoid professional responsibilities. Society, as we know it today, expects more not less from independent auditors. Resistance to this force would be futile and self-defeating.

In a like manner I believe that the Commission charge recognizes two other of Mr. Harlan’s real questions: his second and fifth ones concerning auditors’ ability to influence their future role and the structure to control quality and auditing standards. As before, the Commission charge is phrased in operational
terms rather than the conceptual language used by Harlan. Specifically, the Commission’s questions are these:

1. What mechanisms should be adopted to strengthen the functions of auditors?
2. Is the mechanism for developing auditing standards adequate?
3. What should the profession do to reduce the risks of misunderstanding about its role?

However, this set of questions does not provide much comfort and succor. The last one contains the seed of self-serving limitation of responsibility. It smacks of the context of bringing social expectations down to the level of current auditor acceptability in order to reduce the incidence of lawsuits. A neutral expression of the same concern would allow the possibility that auditors would raise their functions to the level of social expectations, and this possibility is implicit in Harlan’s phrasing of the issues.

In order to summarize on the art of raising questions at this point, let me observe first that four of the issues that Steve Harlan poses and the questions charged to the Commission appear to be closer in spirit than is suggested by him. There still exists the gulf between the meta-conceptual concerns of the other worlds and the operational concerns of professional auditors, and the issue of “who is the client” is apparently to be neglected by the Commission. If forced to a choice, I would find more relevance and meaning in Mr. Harlan’s presentation because it is more conceptual and more cognizant of the real issues.

A Troublesome Dichotomy

The art of auditing is uniquely characterized by investigatory problems of recognizing economic assertions and obtaining evidence related to them. These facets are essentially private concerns of the auditor, becoming public concerns only when an audit report is the center of a dispute (as in a lawsuit). The ongoing public facet of auditing lies in the auditor’s duty to match assertions and evidence to criteria and in the communication of his findings to users. At this latter stage auditing becomes inextricably bound to accountancy and bound to the public interest.

Although I would personally be relieved of many troublesome problems if I, as auditor, could slay the accountancy dragon by declaring the independence of auditors, nevertheless, I fear that I would have only toppled a straw man, and may well have succeeded only in creating more problems rather than fewer. Yet this philosophical independence from accountancy appears to be important to members of the other worlds. The manifestation arises in argumentation over the phrase “presents fairly” and in discussions of reports on controls, forecasts, interim statements and other matters that have largely been given only passing attention in official accounting theory.

Mr. Harlan has fearlessly thrust these accounting questions on the new Audit Commission. Apparently, as a practicing auditor, he does not share my academic proclivity to keep accounting and auditing questions neatly separated. Upon reflection I confess that I too am convinced that it is incumbent on auditors to identify the users and their information needs, thus identifying the appropriate content of audit communications. To undertake such a task would indeed repre-
sent a break with the past and would in fact be a new approach; it would take audit practice out of its own ivory tower and marry it to the other worlds that it purports to serve.

One must recognize, however, that acceptance of these real questions (the third and fourth ones presented by Harlan) could easily lead auditors to many of the same issues currently being addressed by the SEC. We need not be reminded that accountants and auditors are presently resisting many SEC decisions. Nevertheless, to proceed as Mr. Harlan suggests might result in the identification of classes of users (justifying differential disclosure or multiple special statements in place of general financial statements). The Commission might find sufficient demand for attestation to interim statements, forecasts, and other matters currently favored more heavily by non-auditor worlds. As a corollary issue, the Commission could support the efficacy of quality control organizations that would “audit the auditors.” In brief, the new Audit Commission could emerge as a private-enterprise SEC.

Herein lie two possibilities: (1) Rejection of the Commission and resistance of the same type that characterizes current relations with the SEC, or (2) Happy acceptance of the Commission as the means of recovering responsibilities that were slipping away into other-world hands. The latter alternative would require action responsive to the *meta-conceptual* concerns of non-auditors, and in all likelihood would transform the world of auditing.

**In Closing**

Among points that I have thus far neglected is the important matter of *expertise*—that which auditors admit to having and that which others presume they have. I agree that non-auditors may be willing to presume that auditors have greater abilities than the auditors themselves will admit. This incongruence creates a very real barrier to satisfying the meta-conceptual questions. A “marketing” approach may ameliorate the problem, but it must not degenerate into a defense of the *status quo* which is so often characterized as “education of the public.” Auditors should be pleased rather than frightened that the other worlds will grant such recognition of professionalism, and we should begin to accept the societal recognition lest it melt away.

As a summary, I find an appeal in Harlan’s real questions for the new Audit Commission to accept the kind of meta-conceptual questions that other worlds wish to raise. I find too that the operational questions charged to the Commission are technical transformations of some of the real concerns, and I believe that full credit has not been given where it is due. Yet other important issues remain, and if they are not raised, I anticipate with Harlan that we may need another Commission in a few years.