Discussant's response to taxonomization of internal controls and errors for audit research;

John K. Wulff
Discussant’s Response to
A Taxonomization of Internal Controls and
Errors for Audit Research

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The objective of Dr. Vasarhelyi’s project, namely “... to formalize and summarizethe key issues in the relationships between individual internal control procedures, clusters of internal controls, internal control systems and the diverse types of errors which may occur.” is admirable. The sheer number of controls and combinations thereof coupled with the multiplicity of possible errors renders the project particularly challenging. However, the project offers the potential to significantly enhance our understanding of internal controls and thereby to improve existing techniques used to evaluate the effectiveness of internal control systems.

I tend to agree with Dr. Vasarhelyi that a crucial first step in the project is the development of a succinct taxonomy of internal controls and errors. Indeed, the subject of internal control, because of its complexity is difficult to analyze or discuss without first grouping controls and errors with similar attributes.

The development of taxonomies, of course, is not an end in itself but rather a means to assist the author in portraying internal control situations analytically—thereby clarifying the relationship between controls and errors. Because the overall project is only in its initial stages, it is impossible to evaluate the effectiveness of the suggested taxonomies in enabling Dr. Vasarhelyi to achieve his ultimate objectives. The paper, moreover, fails to demonstrate why the particular taxonomies suggested by the author are likely to be more useful than alternative classifications. Under these circumstances, it is difficult and probably premature to either praise or criticize the author’s groupings. Nevertheless, I will make a few brief observations.

Classification of Controls—Exclusion of Management Controls

Dr. Vasarhelyi distinguishes between internal accounting controls and “exclusively management oriented controls” with the stated intention of excluding the latter from his study. It is not clear whether the phrase “exclusively management oriented” refers to the characteristic of the control or its purpose. A budgetary system, for example, is traditionally characterized as an administrative or management control. Nevertheless, effective budgeting (including variance analysis) may highlight unauthorized disbursements and otherwise improve management’s ability to meet internal accounting control objectives. I believe that distinctions between management controls, on the one hand, and internal accounting controls, on the other hand, are, in many instances virtually impossible
to make, either on the basis of control characteristic or control objective. Moreover, even if such distinctions were feasible, the exclusion of management controls which serve accounting control objectives would severely limit the usefulness of Dr. Vasarhelyi's project. The presence or absence of certain management controls such as a budgeting system will impact the relative effectiveness of internal accounting controls. As the AICPA Special Advisory Committee on Internal Accounting Controls noted, "Internal accounting controls cannot be evaluated in a vacuum."

Classification of Errors

The author's attempt to classify errors represents a potentially fruitful line of research—an area which, perhaps, has not received the degree of attention directed to the development of control taxonomies. In this regard, however, consideration should be given to eliminating the "accounting error" category on the basis that all accounting errors may be classified as either "computation" or "GAAP."

Introduction—Historical Perspective

Dr. Vasarhelyi leaves the unfortunate and incorrect implication that the enactment of the Foreign Corrupt Practices Act led to a series of procedural reactions by major CPA firms. In general, the so-called procedural reactions represented the culmination of many years of work initiated long before enactment of the FCPA.

In summary, I believe that Dr. Vasarhelyi's work offers significant potential. Because the project is still in its infancy, it is premature to evaluate the suggested taxonomies. However, I suspect that the author will find it necessary to address more effectively the problem of management controls and their relationships to accounting controls in order to achieve his ultimate project objectives.