Fall 12-2003

AU 311.14: Disagreement and Disassociation

William Martin Coffelt

University of Tennessee - Knoxville

Follow this and additional works at: https://trace.tennessee.edu/utk_chanhonoproj

Recommended Citation

This is brought to you for free and open access by the University of Tennessee Honors Program at Trace: Tennessee Research and Creative Exchange. It has been accepted for inclusion in University of Tennessee Honors Thesis Projects by an authorized administrator of Trace: Tennessee Research and Creative Exchange. For more information, please contact trace@utk.edu.
UNIVERSITY HONORS PROGRAM

SENIOR PROJECT - APPROVAL

Name: William Martin Coffelt, III

College: Business Administration  Department: Accounting

Faculty Mentor: Dr. Jack Kiger

PROJECT TITLE: All §311.14: Disagreement and Disassociation

I have reviewed this completed senior honors thesis with this student and certify that it is a project commensurate with honors level undergraduate research in this field.

Signed: Dr. Jack Kiger, Faculty Mentor

Date: Dec 10, 2003

Comments (Optional):
AU §311.14: Disagreement and Disassociation

William Martin Coffelt, III
Senior Honors Project
Fall 2003

Faculty Mentor: Dr. Jack E. Kiger, Accounting
Table of Contents

Introduction ............................................................................. 1
Possible Reasons for Disagreement ........................................ 2
Elucidation of AU §311.14 ...................................................... 4
Importance of AU §311.14 ........................................................... 6
Conclusions ........................................................................... 7
Figure 1 .................................................................................. 9
Many in the accounting profession consider auditing to be an art and not an exact science. The foundation of auditing practice consists of numerous standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). While auditing standards are designed to direct auditors in the proper initiation and completion of audit engagements, some standards are not as clear or as defined as others. Therefore, an understanding of auditing comes from not only the study of, but also the application of, these standards. As a result, many lessons learned in the field of auditing derive from direct involvement in audit engagements. Additionally, some accounting issues are subject to interpretation, and some auditing issues are subject to professional judgment. Accounting evolves as business transactions evolve; consequently, proper accounting for certain transactions may involve judgment when accounting principles are not clear on the appropriate treatment of such transactions. Accounting also involves estimates requiring a significant amount of judgment. For these reasons and several others, auditing occasionally involves disagreements among firm personnel during the course of an audit engagement. Although these disagreements range from small, inconsequential quarrels over minutia to arguments over the proper treatment of significant accounting issues having a material effect on the audit, the latter clearly must be resolved in some fashion. AU §311.14 details the stance of the AICPA regarding this issue. It states:

The auditor with final responsibility for the audit and assistants should be aware of the procedures to be followed when differences of opinion concerning accounting and auditing issues exist among firm personnel involved in the audit. Such procedures should enable an assistant to document his disagreement with the
conclusions reached if, after appropriate consultation, he believes it necessary to disassociate himself from the resolution of the matter. In this situation, the basis for the final resolution should also be documented. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 48, July 1984.]

This paper will examine issues related to AU §311.14, including reasons for disagreement among auditors, the elucidation of the standard, and the importance of the standard to the auditing profession.

Possible Reasons for Disagreement

A few possible reasons explain the disagreements that occur among auditing professionals. One explanation is the role of professional skepticism and professional judgment in auditing. According to AU §230.07-09, auditors have a responsibility to maintain an attitude of professional skepticism throughout the audit. This means that auditors are to critically assess gathered evidence and not make assumptions about the honesty of management. Depending upon the level of professional skepticism exercised by auditors, disagreements may evolve. For example, an auditor makes the assumption that management is trustworthy and accepts evidence that another auditor or superior auditor finds unacceptable, resulting in a disagreement. Additionally, auditing involves professional judgments in the gathering of auditing evidence and in the interpretation of the results of such gathering. AU §230.10 states that auditors are “to obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud.” This standard of reasonableness alluded to in the previous standard and in AU §230.11 means that auditors often use their judgment to determine the reasonableness of evidence, accounting estimates, the results of audit testing, etc.
Because auditors use their own judgment to determine reasonableness in some instances, disputes take place among auditors concerning the treatment of auditing and accounting matters.

Misunderstandings are another potential explanation for disagreements among auditors. These occur for a couple of reasons. First, with the considerable amount of information auditors are expected to know, misinterpretations of auditing procedures or accounting principles can occur. Becoming an auditor is not an overnight process. As in other professions, auditing takes years of practice to master. As business transactions evolve, auditors must be aware of changes in accounting principles and auditing standards. Since this educational process is continual, auditors are at different levels of professional development and have different levels of awareness with respect to certain auditing and accounting issues. Therefore, disagreements arise because one auditor is not as knowledgeable as another. Second, auditing differs slightly depending upon the industry (or industries) in which a business operates. When auditors transition from auditing within one industry to another, disagreements occur out of a lack of familiarity with the auditing procedures for that industry.

Several other reasons exist for disagreement amongst auditors. Some of the more notable examples are time restraints and the intentional violation of auditing standards. Auditors conduct audits with a consciousness of time. Projected dates of completion for fieldwork, deadlines for the issuance of financial statements, and time budgets are commonplace in the auditing profession. Disputes result when an auditor does not properly complete tasks for the sake of timeliness. For instance, the managing auditor of an engagement requires a staff auditor to complete the assigned portion of the audit
without collecting sufficient evidence in order for the timely completion of the audit. In this case, the staff auditor may conflict with the managing auditor because he/she believes that the audit has not been reasonably completed, which would be a violation of auditing standards.

**Elucidation of AU §311.14**

As a standard, AU §311.14 is both clear and vague simultaneously. This standard makes three clear statements: (1) those involved in an audit should know the procedures followed in the case of disagreement among the involved parties; (2) the procedures should allow an assistant to document his/her disagreement and if necessary disassociate himself/herself from the resolution of the matter; and (3) the final resolution of the matter should be documented. The issues left unclear are the procedures to be followed and the manner in which the aforementioned documentation should be recorded. Because these two matters are left ambiguous, each auditing firm is responsible for determining the proper handling and documentation of disagreements among audit personnel.

The following is an account of the procedures outlined by one accounting firm concerning AU §311.14. Since firms are responsible for determining the details associated with this standard, the procedural information is proprietary. Therefore, beyond the fact that this firm is one of the Big 4 accounting firms in the United States, this account reveals no more about the source for this exposition. This firm’s procedures are illustrated because it represents a prominent sector of the auditing community and thus is suitable for usage as an example.

In this firm’s procedural literature, the protocol with respect to disagreements can involve several levels of authority and extensive documentation of the events surrounding
such disagreements. First, if the matter pertains to a substantive issue and the involved parties (generally members of the engagement team and the engagement partner) cannot reach a resolution, they should discuss their predicament with the Professional Practice Director (PPD) in the local office of the firm. If the conclusion of this discussion is not satisfactory to the involved parties, the PPD passes the matter on to the Regional Professional Practice Director and then on to the National Director of Accounting Consultation, Assurance Services, Quality Assurance, or SEC Services, if necessary. Finally, if no agreement has been reached, the matter is referred to the National Managing Partner – Professional Practice, who should make the decision about the firm’s position on the matter. The procedures permit further appeals beyond this stage, concluding at the Chief Executive Officer. After this process has been completed, a dissatisfied party may disassociate himself/herself from the conclusion of the matter by preparing a written memorandum stating his/her position in reasonable detail and submitting it to the National Managing Partner – Professional Practice before the firm’s report is issued.\(^1\) An auditor must exhaust all possible means of resolving the matter by moving up the chain of authority before the procedures allow him/her to disassociate from its conclusion.

Throughout this process, the firm’s procedures require proper documentation of the initiation and results of each step. The engagement partner originating the discussion is responsible for the preparation of documentation surrounding the dispute, including a memorandum that explains the elements of the disagreement, the facts, the individuals consulted, and the rationale behind any conclusions reached. These procedures treat disagreements or differences in professional judgment as significant documentation

\(^1\) For a description of the possible contents of a disassociation memo, see Figure 1 at the end of the paper.
matters. As a result, documentation of communications with involved parties is also necessary. All information relating to the resolution of the matter, even documentation inconsistent with the final conclusion, is retained in the working papers at the matter’s conclusion. Finally, this information is organized in a manner that illustrates the progression of thought on the matter from beginning to end.

**Importance of AU §311.14**

The importance of AU §311.14 lies in two facets of the standard: procedures for dealing with disagreements among auditors and the ability of an auditor to become disassociated from the resolution of a disagreement. These components are critical to the auditing profession for several reasons. Two reasons relate to liability and professional security. First, this standard is important to reduce the risk of material misstatements in the financial statements of audited businesses. If the financial statements of an audited company are misstated, the firm and those auditors involved in the audit are subject to liability for the misstatement. Through a proper channel for disagreements, auditors can discuss significant matters that involve possible misstatements and come to a conclusion that avoids such misstatements. Second, the standard provides the individual auditor and the firm with a layer of professional security. In the event that an auditor is unsatisfied with the conclusions reached, disassociation reduces the auditor’s liability in the case of incorrectly presented financial statements. By avoiding liability, the auditor evades potential sanctions that would prevent him/her from practicing before the SEC. Also, by circumventing material misstatements through discussion of disputes, the firm preserves its reputation as a respectable, professional organization.
Lastly, AU §311.14 is important to the professional development of auditors and the firm. The procedures stemming from the standard provide a forum for the discussion of disagreements. This forum fosters learning for the individuals involved in a dispute. Through dialogue, auditors observe the thought processes behind the reasoning of their fellow professionals. If an auditor is mistaken in his/her thinking about a matter, the discussion serves as a tool of enlightenment. A policy that allows free and open expression of concerns about significant audit or accounting matters will supplement the development of professionals within the firm.

Conclusions

AU 311.14 does a sufficient job of explaining the responsibilities of auditors in the case of disagreements among those involved in an audit engagement. It also clearly states that a firm’s procedures should allow an auditor to disassociate himself/herself from the resolution of a disagreement. However, the standard does not elaborate on the specifics of the procedures. Fortunately, since firms decide the contents of these procedures, they can tailor them to their needs. Contrarily, because of the standard’s vagueness, uniformity does not exist across the spectrum of auditing firms. The policies of some firms may be more effective or efficient than others. In the previous account, the firm’s procedures require an auditor to go through several levels of consultation before he/she may disassociate from the firm’s position on a disputed matter. Unfortunately, this requirement may discourage auditors from pursuing a continued discussion of a disputed matter and also be costly for a firm in terms of time and money.

In any event, disagreements among auditors are a part of the auditing profession. Since these disagreements occur occasionally, auditors should be conscious of AU
311.14 and its implications. This standard requires auditors on an engagement to be aware of the procedures necessary to resolve conflicts among engagement participants. It also provides an avenue for an auditor to disassociate from the resolution of disagreements. Because this standard is important to the resolution of disagreements among auditing professionals, these professionals should be aware of its existence and the meaning of its content.
<table>
<thead>
<tr>
<th><strong>Disassociation from an Accounting Matter</strong></th>
<th><strong>Disassociation from an Auditing Matter</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Facts about issue</td>
<td>Facts about issue</td>
</tr>
<tr>
<td>Client’s position</td>
<td>Firm’s Position</td>
</tr>
<tr>
<td>Firm’s position if different from client’s</td>
<td></td>
</tr>
<tr>
<td>Your position, well documented with</td>
<td>Your position, well documented with</td>
</tr>
<tr>
<td>authoritative support</td>
<td>authoritative support</td>
</tr>
<tr>
<td>Disassociate yourself from conclusion the</td>
<td>Disassociate yourself from conclusion the</td>
</tr>
<tr>
<td>firm has reached on matter</td>
<td>firm has reached on matter</td>
</tr>
</tbody>
</table>