Highlights from Breakout Discussions

At the Ninth Annual CAQ Symposium, attendees were assigned to small groups to discuss issues raised in the two panel presentations:

Challenges and Opportunities: Auditor Risk Assessment

Innovative Approaches to Learning and Development

Each breakout group, comprised of research academics and senior public company audit practice leaders, was assigned a set of questions to address. Regulators participated in two of the eight small group discussions.

The following summary provides highlights of those discussions, which do not necessarily represent the views of any specific individual, firm, or CAQ Governing Board member.

I. CHALLENGES AND OPPORTUNITIES: AUDITOR RISK ASSESSMENT

Participants addressed several key issues with respect to auditor risk assessments, including the challenges inherent in multi-location audits and documentation of audit risks. The discussions also covered opportunities for improving the risk-assessment process using data analytics, raising awareness of judgment traps, and how risk assessment concepts are covered in the graduate and undergraduate curriculum.

a. Multi-Location Audits

The Symposium panel and the smaller discussion groups addressed the challenges that auditors face when performing risk assessments for audits with multiple locations. Many practitioners noted that the engagement team will perform a centralized risk assessment that is pushed out to the component audit teams. The component teams are then asked to review the centralized risk assessment and report back any additional risks they believe should be included. The centralized approach has its challenges, particularly since accounting systems for most multinationals are decentralized, which can complicate the risk-assessment process. In some cases, the lead engagement partner will send team members to the component audit location to address the issue complexities and needs. An alternative approach is to have the component teams provide location-specific risk assessments that are reported up to the main audit team and incorporated into an overall risk assessment. In both approaches, the engagement team evaluates whether additional audit procedures are necessary to address the added risks on the overall entity or whether the risks are applicable only at the component level.

Capturing component-level risks at the parent level that emerge during the course of the audit can be a challenge. The practitioners hold international components to the same level of reporting and audit standards followed in the US. Close coordination and communication are necessary so that as new risks are identified by the component audit team, the parent level team is aware and can make adjustments to the audit response for these new risks. While group phone calls can facilitate this coordination, there was consensus that actual visits to the component teams are a more effective means of communication of risks.

Assessment of audit risks requires a fundamental understanding of the company’s business model and strategy. If the auditor takes this approach, such information can be used to better evaluate where the financial reporting risks are and which are most critical, several of the group discussants noted. Often the junior audit staff perform risk assessment procedures, and they may not have the appropriate knowledge of the business to do this effectively. However, for important processes, such as revenue or estimates, partners are involved in the risk assessments and the walk-throughs. Junior staff benefit from listening to the partners and managers as they perform risk assessments in these more complex areas, as it contributes to their experience and helps them see the bigger picture.

b. Documentation of Risk Assessment

Some groups discussed the challenges inherent in documenting the conclusions reached in the risk-assessment process used by the engagement team. How risks are documented is important because it is the basis for the conclusion on risks and the audit response to those risks. If the list of risks is extensive and overly broad, it will lead to the auditor having to address the full scope of risks listed, whether or not they are significant. This increases the nature, timing, and extent of testing, even in low-
risk areas. Risk assessment requires professional judgment, often over very subjective factors. Auditors need to clearly articulate the judgment processes they use to determine risks, particularly why it was determined that an area was considered low risk. Academics and practitioners noted that these documentation issues continue throughout the audit. Risk assessment is continuous and reiterative, so auditors need to reassess the criticality of previously identified risks as new risks are added.

Auditors suggested that the risk-assessment process can be improved by requiring the audit team to include in the documentation a flow-chart of the relevant internal controls that address the risk area. This seemed to significantly improve the team’s ability to appropriately evaluate and document the level of risk at the preparer.

c. Use of Data Analytics

Data analytics can play an important role in auditor risk assessment. It can help to enhance critical thinking regarding whether something makes sense in the context of the issuer’s industry. Modeling can be used to develop expectations for transactions in certain accounts and identify those that fall outside of an acceptable threshold; a journal entry “dashboard” can quickly identify outliers. However, analytics presents other challenges, because the datasets are not always “clean” and may generate false positives or false negatives. Many data sources are unstructured, and a great deal of judgment and critical thinking is required to interpret the data output. While visualization tools can help with communicating issues to management and the audit team, auditors still need to have a solid understanding of the underlying accounting and auditing issues. Firms are still in the early stages of developing these tools for use in the audit, but there is general agreement that data analytics has a promising role in the audit of the future.

d. Understanding Human Judgment Traps and Biases

A key to improving auditor risk assessments is being aware of and acknowledging biases. This awareness can challenge auditors to consider what could go wrong and lead them to explore alternative explanations for why things are reported the way that they are. They then seek out contradictory evidence, rather than anchoring on facts from prior-year work papers that confirm their preconceived ideas of what the number, range, or result should be. There is an opportunity to reward staff who can demonstrate their ability to overcome these biases and document their processes and conclusions. Partners and managers should encourage junior staff to seek contrary evidence.

Reinforcing the importance of exercising professional skepticism can help auditors recognize their biases. This can be done with simulations that require auditors to delineate their thought processes. One practitioner suggested that highlighting
to a team member when he or she fell into a given judgment trap is an effective way to raise awareness.

e. Introducing Students to Risk-Assessment Concepts

Some group discussions focused on how risk assessment was taught at the undergraduate and graduate levels. Some academics admitted that the topic is probably not adequately addressed in the auditing curriculum. Identification of business risks is commonly taught in financial management classes. The academics felt that getting students to identify risks was one thing, but helping them to understand how to link those risks to specific financial statement assertions, and ultimately, relevant audit testing procedures, was difficult.

In graduate auditing classes, the focus is on the more theoretical aspects of auditing and the consequences of poor audit quality. Undergraduate courses are mainly focused on the actual mechanics of auditing and its terminology. Most instruction at the undergraduate level is performed through lecture with some use of case studies.

II. INNOVATIVE APPROACHES TO LEARNING AND DEVELOPMENT

For the Learning and Development panel, the breakout groups started with sets of questions focused mainly on two areas of concern for both firms and academics. The first area regards how academics and the profession can develop and enhance the critical thinking skills of both students and auditors. The second area deals with the impact on the profession of new technologies, like data analytics and data visualization. Academics were asked to explain how they are covering these technological developments in the classroom, in a way that both prepares the students as well as keeps them engaged.

a. Critical Thinking

Both practitioners and academics agreed that critical thinking skills are key to high-quality audits. Several participants noted that before it can be addressed in the classroom, or a training session, critical thinking should be defined. However, many said that they themselves do not have a clear understanding of how to measure or teach it.

Several academics noted that the application of critical thinking can be uneven; students will think critically in some situations—for example, with the use of case studies—but not in others. The firms face similar situations. An auditor, for example, may apply curiosity in a training setting but not when out on an engagement.

A participant observed that the law school model—where students are expected to read cases, think critically, and make judgments about the case—may be something to emulate in audit classes. This observation fueled further discussion about the value of a case study approach in audit classes as a means to developing students’ critical thinking skills. An academic noted that students prefer more structured materials that provide exercises and quantitative problems, and will give teachers bad evaluations for using cases in classes that involve more subjective thinking.

A major challenge raised by the academics is that many students have not been taught (or have not had to apply) critical thinking skills prior to taking an auditing class. Like communication skills, critical thinking skills are difficult to teach and assess. Critical thinking skills are often introduced in capstone courses, where the syllabus can better integrate principles of financial accounting and auditing.

Another challenge at the undergraduate level is that students tend to want clear, definitive answers, but auditing has shades of gray, which can be frustrating for students.

A few recommendations were proffered for approaches to teaching critical thinking skills:

- Have students (or, at the firms, auditors) work together in teams so that they can reason out a problem together.

- Make class grades more dependent on the thought processes that students use to get their answers—and not just on whether they get the correct answers.

One practitioner said that in the recruiting process the firms look for students who demonstrate curiosity, as that is a major contributing factor for being successful in the profession. By being curious and thinking critically, auditors can better identify potential problem areas in the audit. Audit staff can
pick this up through on-the-job training if they have the right supervisor, manager, or partner to help in skills development.

b. Technology Training: Data Analytics and Visualizations

It was agreed that data analytics and data visualization will change the way auditors work and that these new tools should be integrated into course work.

For example, with data analytics, auditors can look at an entire dataset of transactions, rather than rely on a sample. Data visualization tools can create graphs and charts to assist in the identification of high and low risk areas. However, the auditor will need to critically consider the source and the quality of the data and how to accurately interpret the findings that are generated. Symposium participants expressed uncertainty and confusion about what universities need to be teaching students about data analytics.

Most academics acknowledged that curricula are only now beginning to modify courses to include big data analytics; they lamented the lack of resources that can be used in the classroom to help students prepare for the audit of the future.

Some practitioners noted that the firms themselves are still figuring out how data analytics will be integrated into the audit. One theme multiple practitioners raised was how data analytics might impact auditing procedures and how the auditing standard setters (PCAOB, IAASB, and ASB) would view those changes. The firms have been in discussion with the regulators on these issues, and practitioners suggested that data analytics probably would continue to play a relatively minor role in audits until there is clarification about its impact on standards.

Several practitioners indicated that since people learn differently, it is important to provide flexibility in training materials to accommodate each of those different learning styles. The importance of presenting all of this information to students in a way that will prepare them and keep them engaged was a real interest and concern to the participants. Overall, participants agreed that students and junior auditors do not need to be experts in artificial intelligence, data analytics, or other technologies, but they must be able to know what the information means and what to do with it when it is produced.