11TH ANNUAL CAQ SYMPOSIUM

AUDIT PRACTICE MEETS AUDIT RESEARCH

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HIGHLIGHTS

FROM BREAKOUT DISCUSSIONS

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During the 11th Annual CAQ Symposium, research academics and senior practice leaders from the CAQ's eight Governing Board firms were put into small groups and assigned a set of questions to address based on the two panel sessions that took place earlier in the day. Regulators from the Public Company Accounting Oversight Board (PCAOB) and the Financial Accounting Standards Board (FASB) participated in two of the eight groups.

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

I. PROPOSED AUDITING STANDARDS – THE THEORETICAL APPROACH TO ASSESSING THEIR IMPACT

Covering Standard Setting in the Classroom

The groups discussed what students learn about the standard-setting process prior to joining the profession. Most of the academics indicated that the standard-setting process and the roles of the various auditing standard setters are covered more in-depth in advanced auditing courses, often taken by master's level students. Advanced auditing courses regularly require students to engage with current proposed auditing standards by requiring them to summarize and/or comment on proposed standards. While participants agreed that standards were important topics to cover, they noted that there is simply not enough time in undergraduate classes to cover everything, especially as the profession continues to evolve. For example, several academics remarked that data analytics is often addressed in courses before students learn about the standard-setting process.

At the undergraduate level, accounting classes tend to focus on the PCAOB standards and generally cover areas where there is convergence with other standard-setting processes. Differences between the auditing standard setters are more likely to be addressed in advanced auditing classes, where there are more opportunities for case studies. Some participants were concerned that fewer and fewer students are electing to take masters classes where some of these concepts are taught.

In response to the discussion around the topic of standard setting, some practitioners said that professionals in their own firms often don't understand the standard-setting process—from identifying the need for a new or revised standard, to the proposed standard, to comment letters, to the final standard. Standard setting is often dealt with by national office partners and senior managers, and there are too many competing priorities for engagement team members. They may only learn about a new standard when it is incorporated into the firm's audit methodology.

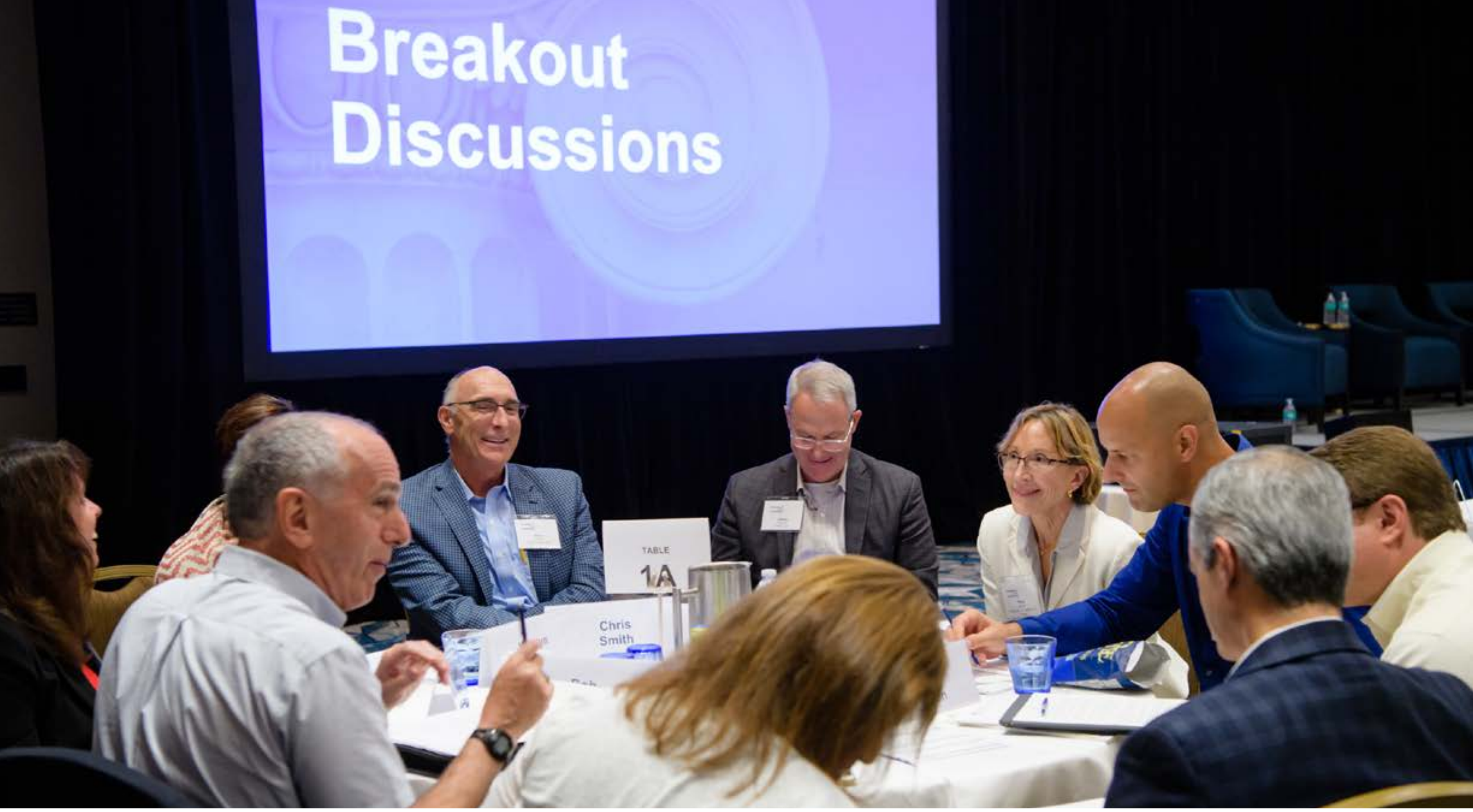
Academics said that their students are generally aware that the profession is regulated, noting that this generation of students grew up in a time where the profession has always been regulated. Students may get exposed to the PCAOB inspection process through their internship experiences. One academic said that he has an audit partner discuss the PCAOB inspection process with his graduate-level class, which provides the students with a better understanding of what it means to be a regulated profession.

Risk Assessment

Participants agreed that risk assessment, both in the classroom and in practice, is a challenging concept. To perform an effective risk assessment, one must first understand the underlying business: how it works, why it works, why certain transactions are made, and so on. The evolution of data analytics techniques has assisted in the risk-assessment process and made it both more effective and efficient. However, using data analytics techniques can pose its own challenges, such as obtaining relevant data from the client and assessing the quality and accuracy of the data provided.

Many participants agreed that the most effective way to teach risk assessment was through case studies. One academic said that she attempts to make it personal—what risks do students face in their own lives, and how do they address those risks? What controls do they consider to mitigate a risk? After a discussion of personal risks, the concept of risk assessment can then be analogized to the business setting.

While both students and practitioners may be able to identify the business risks, it can prove challenging to understand the impact those



risks have on the audit. Auditing firms involve more senior members on the engagement team and have tools and templates developed by the national office to assist in the process—a scenario difficult to replicate in the classroom setting.

External market factors can influence the auditor's risk assessment. Auditors must consider events such as mergers and acquisitions, business life cycles, new competitors in the marketplace, and staff turnover at the company. Several practitioners pointed out the need to remind teams that risk assessment drives all of the audit procedures, and it is important to link the risks and the assertions. Use of technology and data analytics can prove to be useful tools in risk assessment, but the identification of a risk is not an end point; the team must determine how they will address the risk. Ultimately, the use of technology depends on the company's willingness to provide data—not all companies are willing to share data because of security concerns around confidential information.

In the area of academic research, some discussion centered around a study showing that when auditors focus on high risk areas, they are more likely to miss misstatements in low-risk areas. A practitioner mentioned that an internal root cause analysis produced a similar finding.

The discussion turned to how scholarly academic research could inform audit methodology around risk assessment. Some participants suggested that there may be a disconnect between academics and the profession when it comes to scholarly research. Practitioners indicated that it is often difficult to understand the academic studies and, therefore, the results are not used to inform audit practice. Journal articles seem to be written for other academics, and the relevance of the results to practice are not clearly articulated. It was noted that an online journal published by the Auditing Section of the AAA, *Current Issues in Auditing,* provides practitioner summaries of some recent academic research.

II. FROM CONCEPT TO PRACTICE: IMPLEMENTING NEW STANDARDS

The New Auditor's Report

The requirement to report critical audit matters (CAMs) represents a major change in the auditor's report, which previously has been a pass/fail model. Panelists provided insights into how representatives from the CAQ Governing Board firms have been conducting dry runs with their clients in advance of the effective implementation date of the CAM reporting requirements.

Practitioners who participated in the dry runs over the past year found the process to be both very helpful and challenging. Discussions with company management and audit committees were beneficial, insofar as auditors were able to explain their approach to identifying potential CAMs (which tended to be related to the company's critical accounting policies). The challenge for most auditors was how to draft a CAM in plain English, as these complex matters are typically presented in more technical language. The firms' national office teams were involved in the dry run process, reviewing CAMs and providing guidance in the identification and drafting of CAMs.

Also discussed was whether the disclosure of CAMs would be viewed as a negative. CAMs are not intended to telegraph a problem or potential deficiency in the financial statements. They provide transparency into those areas that relate to accounts or disclosures that are material to the financial statements that the auditor determined involved especially challenging, subjective, or complex auditor judgement. It was acknowledged that management and external stakeholders should be educated about the objective of CAMs.

Many participants questioned whether financial statement users would find CAM disclosures relevant and important. As one auditor noted, CAMs will not provide users with new information, so there should be few surprises. There was some discussion about how the markets might react to CAMs—would CAM disclosures cause investors to sell (or buy) shares based on the number and type of CAMs? It was also noted that the value of CAMs is in the additional transparency to the audit process that is provided to users of the financial statements. Several academics noted that the expansion of the auditor's report to include CAM disclosures may increase the perceived value of the auditor to the capital markets.

Introducing KAMs and CAMs in the Classroom

Symposium attendees discussed whether educators are covering key audit matters (KAMs) and CAMs in the classroom. The majority of academics in attendance noted that KAMs/CAMs are only briefly touched upon, if at all, in undergraduate auditing classes. Several academics noted that, due to the amount of material that needs to be covered in an introductory audit class, there is not enough time to cover the topic. Those that teach advanced auditing said that they have included KAMs/CAMs in their courses, although several academics pointed out that they are waiting to cover CAMs in greater depth now that they have been implemented.

Those who discuss KAMs or CAMs in their audit classes provided examples of their approach. One academic noted that he discusses the differences between CAMs and KAMs. Another said that students are required to write a CAM using the final PCAOB standard as a model.

One practitioner suggested that academics could discuss CAMs as a value proposition to illustrate why the role of the auditor is important to the capital markets, while another recommended discussing CAMs with the students when teaching them about risk assessment.

Potential Academic Research Questions

Implementation of a new standard provides ample opportunity for academic researchers. Much of the discussion at the breakout tables centered on how investors would react to the new CAM disclosures. Potential questions included the following:

+ Are the presence (or absence) of CAMs viewed as a positive or negative event?
+ Do investors find CAMs useful?
+ How will CAMs influence investment decisions?

Over time, archival researchers will have sufficient longitudinal data to conduct studies on changes in stock price, number and type of CAMs within industry sectors and across industries, and whether year-over-year the number and type of CAMs change for issuers.

Several academics thought that the introduction of CAM disclosures would prompt behavioral studies in a litigation setting. Serving as "jurors," study participants would consider auditor liability in the context of various scenarios about the presence

or absence of a CAM. One researcher thought a textual analysis of the discussions on analyst conference calls would provide insight into the volume and types of questions analysts raise about CAMs.

There was some discussion about whether CAM disclosures would impact auditor behavior. Judgment and decision-making studies on CAMs could provide insights into how auditors determine what rises to the level of a CAM, but these types of studies might be a challenge to design and implement.

Auditing Accounting Estimates

Several breakout tables discussed challenges faced by auditors when auditing accounting estimates, such as fair-value measurements. Practitioners noted that estimates are inherently hard to audit. The greater the level of complexity, the more likely the audit team is to use a specialist. Even then, it can be difficult for an audit firm's valuation specialist to assess the reasonableness of the client's valuation expert's opinion in situations where they insist that the information and valuation techniques are confidential.

The audit firm's valuation specialists are part of the audit planning process, even in cases where the majority of their work takes place towards the end of the engagement. One practitioner noted that there is a difference between performing (or re-performing) a valuation and gaining comfort over the process that management uses to derive an estimate. An academic wondered why—given the extent of valuation work—auditors don't develop this skillset in members of the engagement team. One answer is that the wide range of assets (e.g., bonds, securities, intangibles, real estate) and valuation methodologies used require a great deal of expertise to become proficient. Hence, firms rely on specialists.

Academic research has shown that confirmation bias—coupled with auditors' reliance on valuation experts—can be a challenge. A body of research addresses how auditors can mitigate confirmation bias, namely by exercising skepticism and seeking out disconfirming or contradictory evidence. The firms' training—especially at the associate and senior associate levels—focuses on teaching how to build evidence, how to ask questions, and how to build confidence to push back (particularly in cases where the specialist doesn't question management's estimate).