



# Highlights From Breakout Discussions

During the first virtual CAQ Symposium, guests from academia and senior practice leaders from the CAQ’s eight Governing Board firms were put into small groups and assigned a set of questions based on the three panel sessions that took place over the course of the two-day event. Regulators from the PCAOB and the SEC participated in five of the eight groups. The following summary provides highlights from those discussions. The highlights do not necessarily represent the views of any specific individual, regulator, firm, or CAQ Governing Board member.

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## MULTINATIONAL GROUP AUDITS

The breakout sessions covered a wide range of topics related to group audits, including the process for performing risk assessments, the challenges faced by group auditors, and how they supervise the work of the component audit teams.

### Risk assessment

Many participants noted that risk assessment and materiality in a multinational group audit inform each other and result in a continuous and iterative process. Participants also discussed that the group audit risk assessment is multidimensional and

does not reside completely with the group auditor. Participants generally believed that the group auditor has heightened visibility into risks at component locations in today’s audit environment; however, the group audit teams may be multiple steps away from where transactions occur. As such, participants discussed the importance of communication of the group audit risk assessment process and the inclusion of component audit teams in such assessments, especially for component teams working in emerging economies where additional risks may be present.

Practitioners also described the importance of group auditors understanding the operations and

drivers of the operations at key locations, such as taxes, compliance, and information technology infrastructure, to inform their risk assessment. Group auditors may use a number of procedures, such as site visits, document reviews, or virtual meetings, to obtain an understanding of locations abroad.

### Group audit challenges

Participants noted the judgment required in scoping the group audit as a challenge. Specifically, the discussion in one of the breakout groups centered on the fact that most audit firms do not publish “bright line coverage thresholds” for scoping a group audit, meaning that the auditor would continue to select components to perform audit procedures until the in-scope components coverage in the aggregate exceeds a set percentage of the company’s consolidated results. One practitioner noted that one of the more challenging elements of multinational group audits is the remaining population of residual components that aren’t individually material, and the fact that there are so many divergent factors that must be analyzed to reach an appropriate scoping conclusion with respect to such residual components. Participants also discussed the difficulty of developing a detailed set of rules at both the firm and regulatory levels for group audits due to the uniqueness of each audit. Participants emphasized that this is why audit firm methodology and auditing standards must remain principles based. The following group audit challenges were also discussed:

- + Whether COVID-19 produced incremental challenges for group audits (At least one breakout group felt that, while auditors have changed how and what they audit due to COVID-19, the fundamentals of the group audit are the same.)
- + Mandatory auditor rotation in certain jurisdictions
- + Language barriers
- + Potential lack of component auditor accountability

### Supervision of a component team

Most breakout groups discussed the importance of communication protocols during group audits to ensure that roles, expectations, and responsibility are clear from the start of the engagement.

Participants discussed the need for communication during group audits to be frequent, fluid, and responsive when unexpected audit matters arise. Practitioners emphasized that such communication can help increase the group auditor’s level of familiarity with the component team, which is a key factor influencing the level of supervision and review required by the group auditor.

Practitioners also noted the importance of the component team’s knowledge and technical ability in terms of US GAAP. Such skills can vary significantly from component team to component team. Accordingly, it is imperative that the group auditor understand the competence of the component team in order to determine where extra supervision or review may be needed to ensure a quality audit.

Another element of supervision and review that practitioners discussed is consideration of whether the component auditor is from a firm within the same global firm’s network or from another network. Participants discussed that, for firms that have a global audit methodology and a global quality control system, consistency between group and component audit work will factor into the level of supervision and review required by the group auditor.

### Potential areas of academic research

Participants discussed potential opportunities for academic research in the area of group audits. Much of the discussion focused on the impact of advancements in technology on group audits and PCAOB Form AP. As it pertains to Form AP, both academics and practitioners expressed concerns regarding the comparability of Form AP data across different multinational audit engagements. One participant stated that outwardly similar companies could require varying levels of component audit work due to systems, centralization, and risk differentials, which would impact comparability. Nonetheless, some questions related to group audits that participants believed researchers could examine were as follows:

- + How does the evolving technological landscape influence component auditor behaviors?
- + How does the increasing use of technology affect the manner in which auditors assess and respond to risk in group audits?

- + What incentivizes and motivates component auditors to behave and execute in a manner that the group audit team expects?
- + What trends or relationships between the complexity of an audit and the quality outcome, if any, can be identified from PCAOB Form AP?
- + Would incremental public information, such as in PCAOB Form AP, with respect to component auditors be meaningful to investors? •

## FIRMS' SYSTEM OF QUALITY CONTROL

Audit firms have been focusing a great deal of effort on their internal system of quality control, as both the PCAOB and the IAASB are in the process of rulemaking on new standards to address how firms monitor the quality of the audits performed. Practitioners are supportive of the approach that has been laid out in the concept release PCAOB issued in December 2019.

There was general consensus in the various Symposium breakout groups that audit quality is difficult to measure. Many firms publish annual audit quality reports that highlight firm leadership and tone at the top, and provide an overview of various aspects of the firm's audit practice, the firm's integration of technology into the audit, and results of internal and external inspections, among other things.

### Root cause analysis and remediation

When firms identify audit deficiencies—through PCAOB inspections, internal inspections, or other quality monitoring activities—they typically conduct root cause analyses. Practitioners discussed that the root cause analysis process for identified audit deficiencies is an extensive and time-consuming process involving several firm personnel. Thus, it is important that the firms get meaningful results from a root cause analysis. Practitioners stated that, generally, there are multiple root causes for a given audit deficiency that fit into one of three categories: audit methodology issues, training issues, or execution issues. Once an issue is identified (e.g., via an audit inspection), initial actions are taken to remediate the concerns for the individual

engagement in question. Practitioners highlighted that, just because a root cause issue is identified for an individual engagement, that does not mean the problem is a pervasive matter.

Many participants also noted that one of the more challenging aspects of a root cause analysis is knowing when to stop the analysis and begin to feel confident that the analysis went deep enough to consider all possible root causes. One academic further stressed the importance of the root cause analysis going deep enough, suggesting that oftentimes a thorough root cause analysis will result in identification of an underlying behavioral issue where academic research could provide insights into the audit decision-making process.

Root cause analyses tend to focus on negative outcomes, and several practitioners noted the importance of examining positive audit quality results. These “no deficiencies” audits can be used as baselines against which to compare other audits.

### Measurement of audit quality

Academics and practitioners noted that audit firms have come a long way in identifying numerous metrics that can be used to evaluate audit quality. Participants discussed that no single metric can capture audit quality holistically. Regarding the specific metrics, practitioners and academics generally agreed that, in terms of publicly available data, financial restatements, accounting and auditing enforcement releases, and inspection findings are preferable measures of audit quality. Participants considered whether the current use of firms' audit quality indicators and key performance indicators to measure audit quality is effective, given that there is not always a direct correlation between the two. Practitioners suggested that additional research would be helpful in this area. Practitioners were also generally supportive of the PCAOB's concept release *Potential Approach to Revisions to PCAOB Quality Control Standards*, and reinforced the importance of the proposed changes remaining principles based.

Technology is being used increasingly in the audit, and will become an important tool for monitoring activities such as audit progression versus milestones, timeliness of reviews, and identification of areas known to be potential issues. Real-time

monitoring on audit procedures can be instructive, as most firms have noted that audits that have a certain percentage of the work completed before the client's fiscal year end tend to be of higher quality. Data-mining techniques have the potential to allow firms to examine factors such as leverage ratios and team learning/training, as well as other factors to see how they correlate to the quality of an audit.

#### Areas for academic research

Several of the breakout groups discussed how academic research could help inform a firm's approach to quality control processes. One group discussed what kind of external reporting investors look for to have confidence that a high-quality audit was performed. Research could explore how much weight investors currently put on the information contained in a firm's audit quality reports.

Are audit quality issues seeded in the firm's methodology or in the behavioral attributes of or methodological in nature? What behaviors threaten audit quality, and what interventions can firms employ to mitigate those threats? Is research on audit decision-making processes available that focuses on positive outcomes? Could psychological research related to whether people are intrinsically motivated to attain a positive outcome or to avoid a negative outcome be applied to audit settings? There is research on behavioral modification that might be instructive. •

#### ICFR MANAGEMENT REVIEW CONTROLS

Many academics indicated that they do not directly teach the SEC's 2007 interpretative guidance on internal control over financial reporting for management, *Commission Guidance Regarding Management's Report on Internal Control over Financial Reporting under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*. Certain academics stated that they may mention this guidance; however, the focus is on the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework and the PCAOB standards. Several academics also expressed concern that students with little to no audit experience may not appreciate the complexity of management review controls.

Several participants discussed the gap between the guidance available to management and the guidance available to the auditor. This gap can cause differing expectations among management and auditors. Participants also discussed whether additional guidance regarding management review controls would help bridge this expectation gap. •