Hey! What's New? 2024-88

Audit Smarter by Reassessing Audit Risk

A recent article in the *Journal of Accountancy,* written by Thomas J. Groskopf, CPA, notes that the AICPA Center for Plain English Accounting (CPEA) developed Reimagining Risk Assessment (RRA) after multiple years of development, thought and reflection. "RRA provides concrete fundamental steps within a firm's audit methodology to reimagine risk assessment in a more focused and efficient way while also reframing it as a strategic opportunity and potential competitive advantage."

RRA starts with reorienting a firm to the core audit objective to lower audit risk to an acceptably low level by identifying risks of material misstatement. "The firm starts its planning, before a client's year end, by identifying risks of material misstatement (ROMMs) and then mapping those ROMMs to applicable assertions, which then become relevant assertions. From there, the auditor formally assesses the risk of material misstatement for all relevant assertions and then designs and performs further audit procedures based on the risks assessed. This process, also known as a "top-down approach," has a ROMM-based focus with numerous benefits. These benefits include:

- Elimination of work related to assertions and/or areas that are not relevant.
- Tailoring audit procedures to specific ROMMs
- Alignment of engagement team members on audit procedures and processes.
- More purposeful and meaningful audit procedures related to internal control to impact the design of substantive procedures.
- Shifting of work hours outside of peak periods (for example, "busy season").
- Reduced audit risk with increases in purposeful, intentional, and meaningful audit procedures.

According to Groskopf, the most important part of RRA, however, is not with the fundamental concepts outlined above, but rather the intangible change management process to gain trust and support for a new way of approaching risk assessment. "Private company auditors may find the process outlined above inefficient and possibly intimidating. For example, high-volume, lower-fee engagements put a premium on efficiency, and the aforementioned process may seem non-value adding in these contexts. RRA works to ease these anxieties by showing that the cost-effective benefits to the process are achievable within the firm's existing audit methodology."

With RRA, he adds, "firms can streamline the process, bringing risk assessment ROMM identification into the firm's philosophy, in a number of ways. Firms can segment their audit practice to identify areas where templates with appropriate tailoring memoranda can be used. Industry niches can be used to identify industry-level ROMMs for engagement teams to consider. Risk libraries for engagement teams to consider as potential ROMMs also serve as a convenient reference point."

RRA provides examples, within a firm's current audit methodology, to identify risks of material misstatement (based on a proper risk assessment) and relate those to assertions within audit areas (which then become "relevant"). This process also identifies areas and assertions that are “not relevant” — an important benefit. Properly supporting an audit area or assertion as “not relevant” justifies limited audit responses in an assertion/area. Showing a proper path to a more limited audit response can help break down cultural resistance and reframe thinking about the importance of risk assessment.

Groskopf, advises that “it is important to acknowledge that senior engagement team members will need to be involved more heavily earlier in the engagement — ideally well before a client’s year end. This may be an area of cultural change for firms. CPEA surveys of members have noted that risk assessment forms are frequently approved by engagement partners well after a client’s year end.”

Globalization, technology, regulation and a shallow talent pool are among the factors dramatically increasing the pace of change in business. Audit approaches, says Groskopf, “need to evolve as well. The CPEA sees firms that embrace risk assessment as being well positioned to thrive in the dynamic business environment by focusing on ROMMs, while avoiding overauditing. Further, audit firms that apply RRA will be well positioned to develop and attract talent, as those firms will be able to clearly align audit procedures and processes with ROMMs, providing staff with meaningful and purposeful work. Conversely, by continuing to cling to BUBS, in addition to standards compliance challenges, audit firms will likely perform procedures out of fear. This will drive staff frustration, monotony, and turnover.”

Groskopf concludes that “thriving in the future will require reframing risk assessment as a core strategic opportunity. Firms have abilities and options to reimagine risk assessment, using existing audit methodologies, where the will is present.”

For much more, see [Audit smarter by reassessing audit risk (journalofaccountancy.com)].