
# Highlights from Breakout Discussions

During the third 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 two panel sessions that took place during the event. Regulators from the PCAOB and the FASB participated in three of the seven 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.

## GEOPOLITICAL AND MACROECONOMIC RISKS

The current operating environment presents unique challenges for financial statement preparers and auditors alike. Although pandemics and wars are not new phenomena, the consequences of their convergence are unknown. Current macroeconomic pressures include ongoing global supply chain instability, challenging labor market dynamics, and increasing risk of recession. Geopolitically, economic sanctions against Russia and rising tensions with China have exacerbated supply chain issues, blocked access to assets in certain markets, and elevated the risk of cybersecurity breach. Participants in the breakout sessions discussed the implications of this complex set of issues for practice and academia.

### Implications for auditor's risk assessment and audit planning

Consensus across several discussion groups centered around two necessary modifications to risk assessment and audit planning in highly volatile economic environments. First, prior-year risk assessments have limited use in periods of high volatility; therefore, they will not be able to fully inform risks in the current period. Second, the engagement team must constantly reconsider how rapidly changing external conditions may affect audit risks.

Regulators and practitioners alike articulated that overreliance on prior-year risk assessments is a problem and that a clean slate approach to risk assessment requires an in-depth understanding of the preparer's business. Additionally, practitioners noted that risk assessment is company and industry specific with exposure to market disruption dependent upon market presence, product mix, customer base, industry participation, etc. Further, it was noted that shifting to a more forward-looking perspective was critical and that evaluating disclosures for completeness received more attention in recent engagements.

One practitioner noted that the inability to rely on prior-year assessments made current-year assessments more subjective and dependent upon auditor judgment. Evaluating the assumptions underlying management estimates was one explicit example of auditor judgment discussed in this context. Regulators and academics agreed that professional skepticism is more important than ever. One regulator expressed concern about the use of probability models in periods characterized by high levels of uncertainty, highlighting both the tendency to attach a measure of truth to quantitative values and a lack of clarity about how to use statistical models in this environment.

Regarding the practice of assessing risk during audit planning, regulators and practitioners agreed that auditors should utilize an iterative process, updating assessments to reflect changing conditions. Additionally, practitioners noted that all levels of the engagement team should be involved in this process and that hybrid and remote work environments present challenges in this regard.

### Opportunities for teaching accounting and auditing

The increasing complexity of the financial reporting and auditing environment creates several opportunities to garner interest in the accounting major and to shore up the pipeline to the profession. Practitioners noted persistent gaps in the skill sets of recent graduates and offered suggestions for possible areas of focus. Included in the discussion of expanded skill sets were critical thinking, written and oral communication, and, specifically relevant to the topic of the current risk environment, risk assessment under conditions of uncertainty.

Academics acknowledged the teaching opportunities provided by the current environment. However, several pain points were also identified that create challenges for attempts to fully exploit the current context. Noted obstacles include the inaccessibility of up-to-date teaching tools (e.g., case studies that reflect current realities) and the fact that accounting courses are already content heavy. Further, advanced topics that have the potential to garner the interest of students are better suited for advanced coursework and are therefore more likely to be incorporated into courses after students have opted into an alternative discipline.

## CLIMATE-RELATED RISKS

In March, the SEC released for public comment proposed regulation that would mandate reporting for climate-related risks reasonably assured to have a material effect on a registrant's business, results of operations, or financial condition. Specifics include greenhouse gas emission metrics and climate-related financial statement metrics that consist of the disaggregated effects on existing financial statement line items. The stated intent of the proposed amendment to the current disclosure rules is to supplement and enhance those disclosures by establishing a baseline for more consistent, comparable, and reliable disclosure about the risks related to climate. Participants in the breakout sessions discussed their expectations for the future of climate guidance as well as its implications for the profession and academia.

### The future of climate reporting

Given the strong stakeholder response to the SEC's request for comment on the proposed rule, predictions were scarcely provided. Participants were relatively certain that some form of enhanced climate disclosure will be established, that the language in the final rule will likely differ from the proposal, and that it is possible the effective date would be delayed. One practitioner noted that without some delay in implementation, it will be difficult to obtain the desired level of consistency from the perspective of both the preparer and the auditor. Further, it was noted that auditors, preparers, and consumers of financial information need time to prepare for the evolution of the reporting requirements even after the proposed rule is finalized. Questions will arise during the early implementation phase, and additional rulemaking or interpretation via Staff Accounting Bulletins may be necessary.

Participants offered up interesting questions around the details contained in the current proposal and its implementation. For example:

+ If there is no effort to harmonize the various frameworks available, how will companies that are subject to multiple frameworks choose to report?

+ How will preparers approach the implementation process—that is, just in time or with sufficient transition time—and how will their choices affect the quality of the disclosure? One practitioner noted that a client has been gathering data to complete a trial of their greenhouse gas disclosure and after nine months has not progressed beyond the collection effort.

+ Do companies already have systems online to track information in such a way that the materiality threshold of 1 percent is possible?

+ Will disclosures differ by industry?

### Implications for the profession

With some necessary clarification on relevant frameworks, the opportunity for the profession to capture a sizable portion of the ESG assurance market was generally acknowledged. Areas of competitive advantage explicitly discussed included professional capacity as well as core competencies built into the audit profession, including independence, professional skepticism, and expertise in quality control systems.

Participants agreed that some upskilling will be necessary, but it was not clear how much. While acknowledging they were well equipped for the task, one practitioner noted that the profession had a considerable amount of learning ahead to provide the appropriate level of assurance. Conversely, one academic noted that the skill set necessary for providing assurance for climate disclosures is not entirely different from those applied to other topics.

Practitioners and the academics agreed that ESG assurance areas could make the accounting profession more attractive to young people who are interested and committed to many of the ESG principles.

### Curricular opportunities

Given student interest in environmental issues, the proposed climate-related disclosure rule presents university- and classroom-level engagement opportunities. One academic noted an on-campus conference with a focus on ESG was scheduled for the fall. Another noted that the accounting curriculum is currently being reexamined because of changes in the CPA exam and that now would be an opportune time to incorporate ESG-related topics.

However, as with the same question posed in the context of geopolitical and macroeconomic risk, the opportunity was met with several inquiries. Although the work to develop ESG-focused courses has begun at the college level, one academic noted that the faculty in the Finance Department at their institution has taken the lead, while another noted that more courses incorporate ESG issues at the graduate level at their institution. The question remains how the topic could be introduced earlier in the curriculum. One practitioner wondered if the course content was delivered at the level of granularity required to consider the implications of climate. Further, given that the situation is in flux, it is difficult to determine how much detail should be incorporated in the classroom. One academic noted that a similar problem arose with respect to the US GAAP/IFRS convergence project that has now been abandoned.

### Potential areas for academic research

+ The proposed 1 percent bright-line threshold for disclosure of the financial impacts of severe weather, natural conditions, transition activities, and identified climate-related risks sparked several related research questions, including:

  ◦ Is the 1 percent materiality threshold relevant, or does it create noise for investors? Is it reliable?

  ◦ To what extent does the 1 percent materiality threshold diminish or offset environmental risk assessments?

  ◦ How does the market perceive differences between the US view on materiality (i.e., a narrow view) and the European view (i.e., a broader view)?

+ What key performance indicators are used to determine the allocation of capital from ESG funds?
+ How do ESG-linked key performance indicators vary by industry?
+ Do analysts weigh certain ESG-linked key performance indicators more heavily than others?
+ Does an observable association exist between companies' ESG activities and staff retention and turnover?
+ How are ESG disclosures changing year over year?
+ Is there information in observed changes in ESG disclosure? For example, are companies switching between available frameworks to obtain more desirable financial reporting outcomes?
+ What are the regulatory implications of assurance provisions for mandated ESG disclosures? For example, are there implications for regulation that prohibits certain types of nonaudit services?