ART OF PROBLEM SOLVING GUIDE

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Members are known for their professional integrity, principled judgement, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.

About this publication

This publication is part of a series which has been developed to assist auditors build the on-the-job skills needed to competently and confidently interact with clients, obtain information in an efficient, professional manner, and escalate relevant information within the audit team.

This publication focusses on developing the problem solving skills required to fulfil an auditors professional obligations.

The publication is intended to supplement each firm's own training, rather than as a substitute for it. It should be read, and applied, in conjunction with the relevant auditing, accounting, and professional and ethical standards. It provides non-authoritative guidance.

INTRODUCTION

OVERVIEW OF THE GUIDE FOR ENGAGEMENT PARTNERS, AUDIT MANAGERS AND SUPERVISORS

This guide has been developed to help you train your audit team to effectively solve problems during an audit engagement. At each audit step auditors are required to make decisions to determine the most efficient and effective way to obtain assurance. It is important that each auditor is aware of their own decision making biases as these impact on the decision making process and ultimately on audit quality. Early identification of these biases and any 'blind spots' or short cuts that may be created by them is critical to the successful delivery of each audit engagement.

OVERVIEW OF THE GUIDE FOR NEW AUDITORS

The purpose of this guide is to help you develop the decision making skills you need to effectively and efficiently undertake an audit engagement.

WHAT IS THE ART OF PROBLEM SOLVING?

In general, all of us apply two different problem solving strategies when approaching each task, such as formulating a question. These strategies are known as 'divergent' and 'convergent' thinking, and are best applied in a complementary manner.

In the table below we describe these two strategies and provide examples of how they can be applied to maximum effect in an audit engagement.

Problem solving strategy	Description	How this applies to an audit
Divergent thinking: individual brainstorming	Divergent thinking is used to generate potential solutions to a problem by recognising cues and links between available information to find explanations that might not otherwise be discovered. With divergent thinking it is important to consider multiple plausible explanations for an unusual item without an explicit, stringent effort to ensure that each explanation is logically valid in light of other knowledge and evidence. It is similar to brainstorming, except that brainstorming is a group activity where divergent thinking generally occurs at the individual level.	Considering factors that could potentially result in a material misstatement (including reconsidering whether the audit team identified all of the relevant factors that influence the recorded amount). Considering potential responses to questions, and potential motivations behind different accounting treatments. To comply with ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, you need to ensure that explanations considered include both intentional and unintentional misstatements.
Convergent thinking: narrowing down your options	Convergent thinking involves focusing the search for a solution. In problem solving, convergent thinking facilitates recognition of weaknesses and limitations in the generated explanations for the purpose of eliminating those explanations that should not be pursued. Convergent thinking enables decision makers to recognise potential areas in which to concentrate their effort and to arrive at a satisfactory solution.	In an audit context it is appropriate to use convergent thinking to test the plausible explanations generated by divergent thinking. Auditors make additional enquiries and gather additional evidence that either supports or contradicts the various explanations received. In light of the evidence gathered, the auditors' knowledge of the business and industry, and knowledge gained in the course of the audit. The auditor considers the plausibility of the various alternative explanations generated during the divergent thinking process.

JUDGEMENTAL BIASES

Judgemental biases are used to help us make decisions, on both an operational and a strategic level. In many cases these judgemental biases are applied to decision making sub-consciously. The use of judgemental biases affects the ability to make neutral decisions, based on the best available information.

Self-awareness is required to understand which judgemental biases are being applied, in order to counteract these.

Judgemental biases include **confirmation**, **anchoring** and **availability**. We explore each of these here.

Confirmation bias: the tendency to seek out, and/or to give greater weight to, information that supports a preconceived position. The confirmation tendency can bias a wide variety of auditor judgements, ranging from only seeking evidence that is consistent with a supervisor's or client's explanation for an unusual pattern in financial data, to placing disproportionate weight on audit evidence that is consistent with a preferred outcome.

This may occur because you automatically assume that the results are similar to previous years, or you believe that the company has not changed the way it operates. Confirmation bias may also arise if an auditor ignores risks which may subsequently arise after the initial risk assessment has been undertaken because they are only seeking evidence to confirm the risks that have already been identified.

An example of a question which displays the confirmation bias is *'Can you confirm that the debtor's balances have been correctly recorded?'* This question indicates that other alternatives have not been considered, such as the risk that management has overstated the debtors balance to inflate their revenue position in order to meet their profit (and bonus) targets.

Anchoring results: having a fixed starting point for a reasoning process and being too reluctant to move far from that even in light of new information obtained.

An example of anchoring in the audit process is when you begin the audit of a specific account by considering the account details from the previous year, or by examining unaudited balances. It would be very easy to be inappropriately influenced by these starting numbers, or unknowingly fail to sufficiently adjust away from an initial starting point. This could result in a lack of objectivity in assessing transactions, estimates, and account balances.

An example of a question often used by auditors which uses 'anchoring' is *'Could you please tell me why revenue has increased from last year?'* The starting assumption here is that the company would earn the same amount of revenue each year and that additional factors, such as external trading conditions, would not have changed the earnings pattern.

Availability bias: the tendency to only consider information that is readily available or that easily comes to mind[1]. Examples of the availability bias in an audit environment include:

- In a brainstorming meeting you may suggest potential frauds that you have recently seen (or read about)
- Biases due to the effectiveness of the search, particularly where clients have provided you with explanations and data which affect the search process.

The tendency towards availability bias limits alternatives considered, or information gathered, to the alternatives or information that readily come to mind. The availability bias can be especially common as auditors typically work with several clients. Information from recent events and audits are likely to be fresh in your mind, and you may unconsciously apply less relevant information or conclusions from prior situations to the current audit.

This question gives the client a readily available response, and would quickly allow you to move onto the next audit area. However it does not explore all possible alternative explanations, such as the fact that the website costs may have been inappropriately capitalised in the past.

An example of a question often used by auditors which demonstrates the availability bias is:

'I know last year you capitalised your website costs, as you were developing a sales component to your website. Is that the reason you have capitalised website costs this year as well?'

These judgemental biases, and others such as 'Shooting from the Hip' and 'Plunging in', are discussed in more detail in the Professional Scepticism Online Training Tool[2].

TIP:
Escalate your concerns! Excessive scepticism may lead to gathering and analysing more evidence than is actually needed to support the audit opinion, otherwise referred to as 'over-auditing'.

Finding the balance between applying professional scepticism and following up on all potential lines of enquiry is an important skill to develop. It is always a good idea to discuss your concerns with your supervisor or manager. Escalating your concerns within the audit team will also result in greater awareness within the team and enable more experienced team members to use their professional judgement appropriately and make informed decisions regarding the best course of action.

[1] Tversky, A. and Kahneman, D. (1974). *Judgement under uncertainty: Heuristics and biases. science,* 185(4157), 1124-1131
[2] **http://www.charteredaccountants.com.au/Training/Resources/eLearning/Professional-Skepticism**