

# Developments In Business Simulation & Experiential Exercises, Volume 19, 1992

## THE ADVANTAGES OF EXPERIENTIAL LEARNING IN THE AUDITING CURRICULUM

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### ABSTRACT

This paper discusses how experiential learning can be an effective teaching method in the auditing course. An experiential learning project presently used in an auditing course is discussed.

According to a survey of undergraduate auditing education (Frakes, 1987) the major problems in undergraduate auditing education are in the areas of curriculum design, development of relevant teaching materials, and dissemination of technology. Our experiential learning project addresses these problems.

There are two aspects to an auditing course, teaching the theory of auditing and teaching the practice of auditing. Teaching the theory of auditing may be adequately covered through the use of a textbook, however, the practice of auditing is difficult to convey through a textbook alone. Practice sets are available to help teach the practice of auditing. However, providing an experiential learning project that simulates an actual audit environment with a real company can provide the students with a more realistic approach to the audit process.

This paper discusses how an experiential learning project that simulates an actual audit environment may be a useful tool to convey in a more realistic fashion the practice of auditing. This approach is consistent with the 'White Paper' and the Accounting Education Change Commission's charge to improve accounting education to better prepare students for their careers in accounting.

### INTRODUCTION

#### The Auditing Course

The auditing course is a required course for an accounting major and is typically one of the last courses taken for the accounting degree. The auditing course teaches financial statement auditing which is a review of the financial statements by an independent third party. The review is to determine if the financial statements present fairly the financial position of the company. There is not a universal checklist on how to perform an audit. The exact procedures utilized during an audit and exactly how those procedures are documented is up to the discretion of the individual auditor and the auditing firm. Because of this, auditing is a difficult course to teach. The students want a 'right answer' about exactly what audit procedure should be used and exactly how that procedure and the evidence gained from it should be documented in the working papers. The working papers are the written documentation kept by the auditor that substantiates the work performed during the audit.

#### Skills the Auditor Should Possess

Deciding what to teach in an introductory auditing course is difficult because there are many skills that an auditor should possess. An auditor must have a good understanding of the 'rules' utilized in financial accounting. These skills are generally taught in the intermediate and advanced financial accounting courses. An auditor must have good oral

communication skills and have the ability to deal with people, especially in adverse situations. Typically an auditee is not all that excited to see the auditor and may be uncooperative. It is up to the auditor to gain and document the necessary evidence to do their job while at the same time appeasing the client so the auditing firm will be hired back again next year.

An auditor must have good written communication skills to enable them to appropriately document their work and the findings in the working papers. If an audit is later brought into question, the working papers are the only documentation the auditor has to substantiate that an adequate audit was conducted under the circumstances. An auditor also needs the ability to work in teams. A typical audit involves individuals with all levels of experience within the organization. An audit team can include several entry-level auditors, a supervisor instructing the entry-level auditors, a manager to oversee the supervisor, and a partner of the CPA firm overseeing the entire audit. If an auditor does not possess the necessary skills to work together with others the probability for advancement will be very low. The auditor also needs to understand the mechanics of an audit including what types of evidence should be acquired and different ways to acquire the evidence.

### CONDUCT OF AN AUDIT

The first part of the audit process is to obtain and document evidence about the client, their business, and the industry. This includes investigating the client's top management, their competitors, and contacting their attorneys and bankers. The accounting practices of the industry and the particular business are also investigated. A procedure termed "analytical review" is then performed. Analytical review involves comparing the company's financial history over a period of time, typically three to five years. The financial information is obtained and analyzed to determine if the current year's numbers appear appropriate in light of the past years. Dollar changes and percentage changes in the account balances are investigated as well as comparison of the financial ratios for the period of time studied. The evidence gained during this process is documented in the working papers.

After this initial phase of investigating the client the study and evaluation of internal control is performed. The auditors must gain an understanding of the client's accounting system and document in the working papers how it operates. The internal controls in the accounting system are then tested to determine if they are working effectively. If the internal controls are operating effectively, further testing may be reduced, if the internal controls are not operating effectively further testing may need to be increased.

Subsequent to the study and evaluation of internal controls the tests of the accounting transactions and the account balances are performed and documented in the working papers. This is generally where most of the time is spent during an audit.

Subsequent to the testing an audit report is written. The audit report is the "final product" of an audit.

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## TEACHING AUDITING

There are generally two aspects to the auditing course, teaching the theory of auditing and the practice of auditing. The theory of auditing may be taught using the available textbooks, however, the practice of auditing cannot be easily conveyed with only a textbook.

### Traditional Approach

To teach the practice of auditing, most auditing courses incorporate a "practice set". Typically auditing practice sets are very structured with all of the information necessary to complete the audit contained in the practice set purchased by the student. This type of "canned" learning approach does not simulate a real world audit climate. In actuality, the information is not readily available to the auditor in a packet. Also, an auditor must decide what documents to review. By providing a practice set to the student, in essence that decision is made for the student. The student proceeds with the idea that they will use all the documents in the package, and only the documents in the package. Little or no decision has to be made on the selection of documents to review. In this paper we discuss an audit simulation that is unstructured and allows the students to develop their analytical and thinking skills. Furthermore, it provides a great deal of ambiguity, which the students will face in actual audit environments.

The practice sets typically available to auditing professors are purchased by the students as a "packet" of information. The packet of information contains a "company". Included in the packet is a company name, company description, and company documents for the accounting transactions for a period of time. The packets generally include a general ledger, a cash receipts journal, cash payments journal, purchases journal, and sales journal. They also have copies of related source documents such as cancelled checks, purchase and sales invoices, and remittance advices. The students then proceed, typically alone, with the audit of the company with all of the available information to complete the audit within the packet.

Computerized practice sets are also available in different forms. Some of the computerized practice sets have all of the necessary information to complete the project available on the disk, others have only portions of the practice set on the disk and the rest of the information is contained in hard copy form.

## EXPERIENTIAL LEARNING - AUDIT SIMULATION

The typical practice sets are not realistic with respect to a real world audit environment where the information required to complete an audit is not enclosed in a "packet". In a real world audit the documentation reviewed by the auditor is up to the discretion of the auditor and is not available in an organized fashion from the company being audited. A real audit is a relatively vague and undefined situation and is performed in teams.

Our experiential learning project addresses the more complex nature of the audit process. Experiential learning features concrete experience, reflective observation, abstract conceptualization, and active experimentation (Baker, Simon, Bazeli, 1987) which are all reflected in the simulation. Kolb (1984) has shown an association between the stages of the learning cycle and the type of instructional strategy that is most effective in that stage. We have addressed this with the simulation. Auditing is a capstone course in the accounting curriculum and the students are able to comprehend a more complex project.

For the audit simulation a publicly traded, local, retail company is selected. A publicly traded company provides availability of financial data. A local company allows the students to be familiar with the company operations and follow the company in the local news media. A retail company enables the students to take a tour of the sales facilities and document the control system used for sales.

The audit simulation, an experiential learning project, allows for the ambiguity of the audit environment while also trying to convey some of the concepts of auditing. The simulation is completed in a team setting to simulate the real world. Through working together and sharing ideas the team approach helps to reduce the students anxiety due to the "vagueness" of the assignment where there is not a "correct answer key".

### Investigating the Client

The experiential learning project begins with the students investigating the client. The project uses a company actually in existence so the students will be able to find background information about the company through the financial statements and press releases. The use of databases such as Lexis, NAARS, and Lotus One are particularly effective in this process. The students need to determine what information to obtain and what information to document. The students then prepare an audit program. An audit program is a list of steps the auditor must complete. Writing the audit program helps the students to organize their thoughts and proceed with the client investigation in an orderly manner.

Since the students do not actually have access to the corporations, at times they will not be able to find out the necessary information, or the information is not publicly available. In these situations the students are allowed to assume a logical answer. For example, if the students are unable to determine who the corporate attorneys are, (and will not be able to contact them), the students may locate a prominent law firm in the telephone book and document that firm as the client's firm and make some intelligent comments on what the attorneys may be doing for the client in the past year based on the press releases the students have been following. Even though the law firm may not be the correct firm, the students have gone through the process of learning that they must document and communicate with the client's attorneys. The information is not just handed to them in a packet. They have to locate the information.

### Analytical Review

The next phase of the audit process is typically analytical review. Analytical review involves calculating dollar and percentage changes from year to year, percentage financial statements, and ratios, and then examining these changes for reasonableness. The students will need as much financial information as they have access to in order to complete this phase. Performing analytical review in this manner can simulate the real world where not all of the financial information is perfect and always available, as in a practice set.

Analytical review will be a problem for the students because they will be working directly with the financial statements where all of the accounts have been aggregated, and not with the general ledger where the balances of the individual accounts are. Again, this just provides a better simulation, teaching the students how to trace the transactions back to their source documents.

Generally, the students do not have access to the client so they will not be provided with exact answers for why accounts have increased or decreased. This situation is fine because it teaches the students to think and reach logical conclusions about accounts, consistent with their current

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information about the company and their accounting knowledge. Students learn that even with knowing very little about the company they can determine if balances appear reasonable. For example, the students can calculate the reasonableness of interest expense using the loan payable balance times the prevailing interest rate.

The students will be frustrated because generally they are not trained for, and do not have to deal with, this type of ambiguity in their academic courses. It is not expected that the students will complete a perfect analytical review, it is expected that they will complete the mathematics of the ratios, and the dollar and percentage changes from year to year, and attempt to try to determine with their available knowledge if those changes appear reasonable.

The students are instructed to use word processing software to document their findings and spreadsheet software for their calculations. Five years of financial data are listed in the rows of the spreadsheet and the dollar changes and percentage changes are then calculated and inserted between the years. Percentage financial statements are also calculated where sales is one hundred percent for the income statements and total assets is one hundred percent for the balance sheet.

### Internal Control

Subsequent to analytical review the study and evaluation of internal control is performed. The study and evaluation of internal control entails documentation of the clients system either by flowchart, narrative, or questionnaire and the analysis of the strengths and weaknesses of the clients system so the audit may be modified accordingly.

The students document the system based on their observations during the tour of the client's retail outlet. The students then assess the strengths and weaknesses of the accounting system and discuss the appropriate steps to be taken by the auditor because of these strengths and weakness. This step requires the students to think and there is no right answer, simulating the working environment auditors face.

### Audit Testing

The simulation does not cover the testing phase of an audit. Testing may be adequately simulated through a practice set or through the alternatives mentioned later in the paper.

### Audit Report and Letter to Management

Finally, even though the students generally have not completed an entire audit, at this point they write an audit report to reinforce that the audit report is the final product of the audit.

### TIMING

The simulation is a term long project. The project is introduced on the first day of the term. The students are instructed to begin searching the media for any information about the company and obtain copies of the company's financial statements.

Immediately after the chapter in the auditing text on investigating the client is covered (generally the second or third week of the term) the students are instructed to begin the audit program for that section. A due date is set for the audit program and the students turn it for review. A due date is then set for turning in the client investigation and

analytical review at which time it is reviewed and feedback in the form of review notes are provided to the students. Subsequently the students turn in the Internal Control section for a review then the entire project is turned in to be graded. The periodic turn ins help the students pace their work on the project and also simulate the review process that occurs during an actual audit. The students are also instructed to maintain a time budget for each section which is required on an actual audit.

### ALTERNATIVES

There are many possible modifications to the experiential learning project. The instructor may let the students select the business. Each team may work on a different business. The students may select private companies which they have access to records, or convince companies to allow them to have access to their records for the benefit of having an "audit" performed. The students may also audit the business or other clubs on campus such as Beta Gamma Sigma and Beta Alpha Psi.

To shorten the simulation the instructor could provide to the students the audit program for the investigation of the client and provide a flowchart of the accounting system to the students. This eliminates the time required for the students to prepare the audit program and/or flowchart. The instructor could also omit sections of the simulations such as analytical review or internal control.

For internal Control the students may use the accounting system they developed as a project in the Accounting Information systems course. In the auditing course the students would document the strengths and weaknesses of that system and suggest the necessary audit steps to test the system.

Groff (1989) discusses how lack of experience with real accounting systems can hinder the understanding of internal control concepts in accounting information systems courses. Groff uses experiential learning with simulation to overcome this deficiency. Using the simulation stimulates class participation and achieves greater understanding of fundamental internal control concepts. Groff's simulation maybe incorporated into our experiential learning project.

To add breadth to the assignment, at the same time the students are monitoring the media for information on the company they are auditing have them also monitor the media for any press releases about any company that may have an impact on the financial statements. Examples are dividend announcements, write downs of assets, and selling or buying subsidiaries.

### CONCLUSION

There are two aspects to an auditing course, teaching the theory or auditing and teaching the practice of auditing. This paper discusses a simulation approach for teaching the practice portion of the audit course. The advantage of the simulation approach is the close approximation to an actual audit experience as opposed to the typical practice set approach which provides the students everything they need in a packet and does not require as much thinking on the students part. The experiential learning approach is in line with the "White Paper" and the Accounting Education Change Commission of requiring students to think and write more during their educational experience to prepare them better for their careers in accounting.

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Baker, Simon, and Bazeli (1987) think the optimal teaching mode for most accounting courses is the experiential learning model. The final objective of the learning experience is the ability to apply the concepts to the real-world experiences the students will face upon graduation. In our experiential learning project the student is gaining experiential knowledge of the world he or she will be participating in and acquiring the necessary life skills to be successful within that world.

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