
A STUDY ON HOW FIRMS CONCEPTUALISE AND APPLY PROFESSIONAL SCEPTICISM IN AN AUDIT CONTEXT



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Professor Nonna Martinov Bennie, Associate Professor Maria Cadiz Dyball and
Professor Philomena Leung, Macquarie University



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This study had two aims: 1) to examine how firms conceptualise and apply professional scepticism in an audit context and 2) to investigate firm perceptions of the links between professional scepticism and audit quality. The data for this study was obtained from semi-structured interviews with 15 audit partners, directors and managers from large and medium-sized audit firms with offices in metropolitan Sydney and Melbourne. The interviewees – nine males and six females – had an average of 20.6 years of professional experience. Eleven were from Big 4 firms and four from medium-sized firms. Nine were partners, three were directors and three were managers. Audit partners, directors and managers were chosen as the best interviewees for a study with this focus. They have the knowledge and experience to respond to the kinds of questions raised, and they are also in a position to influence an audit firm's strategic approach to professional scepticism.

Conceptualisation of professional scepticism

Firms perceive professional scepticism as both a disposition and a process. An auditor would have a disposition that is open minded, does not have preconceived ideas, looks at things from different perspectives and is able to challenge.

"It's in a person's nature. If you don't have that enquiring mind to begin with, you're going to struggle regardless."

"Some people are more sceptical than others innately."

As a process, professional scepticism would involve identifying inconsistencies between information sources. Inconsistencies are identified from information sourced from other stages and procedures in the audit including risk assessment and analytical reviews, firm, industry and general business knowledge and prior experience of irregularities in clients' activities and records.

Professional scepticism is perceived to be a disposition that can be developed in most auditors. There are auditors, however, who would never 'get it' and they are those who are not generally suited for the audit profession.

"As an auditor, you are not going to be much good, if you are not sceptical."

Current recruitment practices, however, do not include screening potential employees for the attribute of professional scepticism as there are other attributes that are sought ahead of scepticism such as knowledge of accounting, team and communication skills.

Developing professional scepticism requires both formal and practical training.

"Scepticism can be trained in over years as well".

"It is a skill because it's certainly something – I mean I certainly learnt it over time".

Formal in-house training and self-directed learning would contribute about 25% and on-the-job training the remaining 75%. Firms provide training that reflects the different levels of experience of staff. Formal training generally covers raising awareness of the importance of exercising scepticism

and providing staff with techniques to recognise inhibitors to the exercise of professional scepticism such as cognitive biases and compromised independence. Informal on-the-job training primarily involves the review process wherein supervisory staff prompts junior staff to question and corroborate evidence from clients.

“Doing the review, particularly in people of younger years, is to challenge them on – how did you get happy with it, how did you satisfy yourself? In my mind, the critical training of this is in on-job training.”

Firms, therefore, are of the view that the attribute and application of professional scepticism could be enhanced over time with formal training, proper supervision and exposure to diverse audit clients and industries.

Application of professional scepticism

Professional scepticism was described as being incorporated into work practices and applied at all stages of the audit process (e.g. audit planning and risk assessments, audit evidence gathering and audit evaluation). It is incorporated into audit programs and review processes.

Senior staff members are typically expected to exercise scepticism at all stages of the audit compared to junior staff who may not be exposed to strategic aspects of an audit engagement including evaluating management representations versus performing substantive audit tasks.

Factors associated with professional scepticism

The table below identifies factors along two axes: (i) factors facilitating or hindering scepticism, and (ii) factors intrinsic or extrinsic to the auditor.

	Enabling scepticism	Inhibiting scepticism
Intrinsic to auditor	Technical / Analytical Skills Lack of preconceptions Proactivity Open mindedness Independence Confidence Good communication / listening skills Audit experience Client and industry knowledge	Lack of technical skills Cognitive biases Lack of proactivity Too much trust Lack of assertiveness Cultural subservience Audit inexperience Lack of client and industry knowledge
Extrinsic to auditor	Formal training Structured audit program Strong reporting hierarchy Sufficient audit resources Fastidious audit review processes Culture – tone from the top	Automated working papers / checklist approach Time pressures Inadequate audit resources Weak reporting hierarchy Culture – tone from the top

The link between professional scepticism and audit quality

The link between professional scepticism and audit quality was examined by exploring the impact of professional scepticism on key risk assessments during the audit planning and on evidence gathering and evaluation.

The impact on key risk assessments during audit planning

The application of professional scepticism is required in key risk assessments despite a risk methodology and prescriptive risk-based standards.

“You can follow the risk manuals and requirements and you can still get it wrong if you're being told things and you're not being sceptical and you don't challenge.”

“Scepticism is intrinsically linked to your assessment of risk.”

The flow on effect and importance of identifying key risks and its link to the use of professional scepticism at other stages of the audit was also noted.

“If we haven't identified the risk areas of the audit we can apply professional scepticism to all the other areas and may have missed the biggest thing.”

The impact on evidence gathering and evaluation

“Professional scepticism takes it further. The challenge is, how do you train your team to not just find the evidence to support what you've been told, but to actually challenge, is what you've been told the correct thing?”

“Well maybe that person's exercising (professional scepticism) too much and it really comes back to materiality. Are they focussed in on the material areas where there could be risk that could influence a different opinion?”

Overall, the degree of application of professional scepticism impacts on the quantity and quality of evidence gathered. However, there are factors that would help determine an 'optimal' level of applied professional scepticism including identified risks and materiality levels.

The link between professional scepticism and audit quality

“Scepticism is a significant critical characteristic of the audit process”.

“Scepticism is a driver of audit quality”.

Exercise of professional scepticism is considered to be an important input into all key stages of the audit process and has been identified as one of the key drivers of audit quality.