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# THE ART OF PROFESSIONAL SCEPTICISM: AN OVERVIEW OF THE SERIES

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### About this series

This series has been developed to assist auditors build the on-the-job skills required to competently and confidently interact with clients, obtain information in an efficient, effective and professional manner, and to escalate relevant information within the audit team.

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

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## INTRODUCTION

### OVERVIEW OF THE SERIES FOR ENGAGEMENT PARTNERS, AUDIT MANAGERS AND SUPERVISORS

This series has been developed to help you train your audit team to apply professional scepticism - a skill considered by many as the cornerstone of audit quality.

While there is no substitute for on-the-job-training to provide auditors with the skills and knowledge to apply professional scepticism, this series provides a number of useful tools including guidance documents, a decision tree and case studies for specific audit sections. It is intended to supplement the supervision, review and coaching you provide your audit team.

Other useful ways to train your auditors to ask questions that demonstrate the application of professional scepticism include role playing client interviews and initiating regular 'challenge' sessions (ie what has made you comfortable with the client responses and evidence obtained in this section?). You could select scenarios from the case studies included in this guide, or use the decision tree, to help frame these conversations. You may also like to use the Professional Scepticism Online Training Tool<sup>1</sup> to identify your own decision making biases so you can effectively coach your audit team.

### OVERVIEW OF THE SERIES FOR NEW AUDITORS

The purpose of this series is to help you develop the skills you need to demonstrate that you can effectively apply professional scepticism in an audit engagement. This will enhance your auditing skills and provide a solid basis for a fulfilling career as a professional Chartered Accountant.

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<sup>1</sup> <http://www.charteredaccountants.com.au/Training/Resources/eLearning/Professional-Skepticism>

# WHAT IS THE ART OF SCEPTICISM AND WHY IS IT IMPORTANT IN AN AUDIT?

The word scepticism is derived from the Greek word “skeptikos” which means to “enquire or reflect”. To enquire is to “seek information by questioning; to ask”. In the audit context scepticism relates to the process of seeking information through client enquiry using a combination of relationship, questioning and problem solving skills. This series will help you to work through an established thought process to obtain information in a manner which is efficient and effective and encourages you to comply with your professional obligations by developing skills in each of these three key areas.

## PROFESSIONAL OBLIGATIONS RELATING TO PROFESSIONAL SCEPTICISM

The international auditing standards (ISAs) define professional scepticism as an *‘attitude that includes a **questioning mind** being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence’*.<sup>2</sup> [emphasis added]

As the definition highlights, professional scepticism relates to the audit team’s ability to obtain, and critically analyse, information from the client and third parties, such as independent experts like valuers.

The ISAs outline the requirements for applying professional scepticism, and the closely related concept of professional judgement, in an audit engagement. Paragraph 15 of ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, requires auditors ‘to plan and perform an audit with **professional scepticism** recognizing that circumstances may exist that cause the financial statements to be materially misstated.’ ISA 200 also provides guidance on what constitutes professional scepticism (paragraph. A18–A22).

This series will help you apply professional scepticism throughout the audit process in line with the requirements and guidance provided in the auditing standards.

## LINK BETWEEN PROFESSIONAL SCEPTICISM AND PROFESSIONAL JUDGEMENT

Professional scepticism and professional judgement are closely linked concepts.

The ISA’s require you to exercise both professional scepticism (as noted above) and professional judgement in planning and performing an audit of financial statements<sup>3</sup>. A useful way to think of the linkage between professional scepticism and professional judgement, and how this impacts on your role as an auditor, is demonstrated in the diagram below:

### DIAGRAM 1: HOW PROFESSIONAL SCEPTICISM DRIVES ACTION<sup>4</sup>



<sup>2</sup> ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, Para. 13(l)

<sup>3</sup> ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, Para. 16

<sup>4</sup> Extracted from the International Auditing and Assurance Standards Board (IAASB) Invitation to Comment (2015) *Enhancing Audit Quality in the Public Interest, a focus on Professional Scepticism, Quality Control and Group Audits*

## PROFESSIONAL SCEPTICISM AND UNDERSTANDING YOUR CLIENT

In order to ask good questions, build effective client relationships and apply professional scepticism, it is important to develop a really good understanding of your client, its business and the industry or sector it operates in. Doing so will allow you to move from an 'understanding' to a 'challenging' mind-set, one that is able to appropriately question your client and add valuable insight throughout the audit process<sup>5</sup>.

This is a good way to keep both your client and your audit supervisor happy!

### HOW CAN I FIND OUT MORE?

It's easy. Further information has been provided in the following guides:

- The Art of Enquiry
- The Art of Relationship Building
- The Art of Problem Solving
- Spotlight of Specific Audit Areas

Our Professional Scepticism Online Training Tool<sup>6</sup> also provides auditors with the opportunity to challenge individual auditors approach to scepticism by using audit based scenarios.

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<sup>5</sup> Note: Developing a thorough understanding of your client and their systems, processes and controls is also a core requirement of ISA 315 *Identifying and assessing the risks of material misstatement through understanding the entity and its environment*

<sup>6</sup> <http://www.charteredaccountants.com.au/Training/Resources/eLearning/Professional-Skepticism>

## GLOSSARY OF TERMS USED THROUGHOUT THE SERIES

**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.

**Availability bias:** the tendency to only consider information that is readily available at hand or that easily comes to mind.

**Confirmation bias:** the tendency to seek out, and/or to give greater weight to, information that supports a preconceived position.

**Convergent thinking:** a problem solving technique involving the bringing together of different ideas from different perspectives to determine a single solution to a clearly defined problem.

**Divergent thinking:** the strategy of solving problems characterised by the proposal of multiple possible solutions in an attempt to determine the most appropriate one.

**Going concern assumption:** an entity is viewed as continuing in business for the foreseeable future.

### **Related parties:**

(a) a related party as defined in the applicable financial reporting framework; or

(b) where the applicable financial reporting framework establishes minimal or no related party requirements:

- (i) a person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
- (ii) another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
- (iii) another entity that is under common control with the reporting entity through having:
  - a. common controlling ownership;
  - b. owners who are close family members; or
  - c. common key management.

However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

**Segregation of duties:** an internal control designed to prevent error and fraud by ensuring that at least two individuals are responsible for the separate parts of any task.

**Those charged with governance (TCWG):** The person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.

## REFERENCES AND OTHER RESOURCES

ACCA (2015) *The Audit of Related Parties and the Application of Professional Skepticism* available at <http://www.accaglobal.com/an/en/discover/cpd-articles/audit-assurance/related-parties15.html>

Australian Audit Manual and Toolkit (2016) available at <http://legal.thomsonreuters.com.au/australian-audit-manual-toolkit-for-smes-2016-book/productdetail/124670>

The 'consider points' are useful for each audit section and for understanding what is required. The Manual explains how professional scepticism should be applied in each example (such as evaluating internal controls on pages 460–461). The individual case studies and Part B 'Practical Guidance' are also useful.

Centre for Audit Quality (2014) *Professional Judgement Resource* available at <http://www.thecaq.org/docs/reports-and-publications/professional-judgement-resource.pdf?sfvrsn=4>

This Resource includes checklists, an overview of the decision making traps and scenarios to illustrate the decision making traps and how to avoid them.

CA ANZ (2015) *Professional Scepticism online training programme* available at <http://www.charteredaccountants.com.au/Training/Resources/eLearning/Professional-Skepticism>

The *Professional Scepticism Online Training Tool* guides audit partners to question more junior audit staff (including the audit supervisor), encourages questions to be asked in a neutral manner and allows the auditor to develop confidence as they learn. The focus of the tool is on questioning within the audit team, rather than questioning the client. However the approach to questioning, emphasising the use of professional scepticism, is common across both.

Epstein, Dr B.J. (2015) *Auditor Liability and Professional Skepticism: A Look at Lehman Brothers and MF Global* available at [http://www.epsteinnach.com/wp-content/uploads/2015/06/Auditor\\_Liability\\_Professional\\_Skepticism\\_White\\_Paper\\_Final.pdf](http://www.epsteinnach.com/wp-content/uploads/2015/06/Auditor_Liability_Professional_Skepticism_White_Paper_Final.pdf)

EY (2015) *Better Questions* material available at <http://www.ey.com/GL/en/About-us/Our-global-approach/Global-review/Global-review-2015---home>

Glover, S.M and Prawitt, D.F. (2013) *Enhancing Auditor Professional Skepticism*, Global Public Policy Committee, available at [www.thecaq.org/docs/research/skepticismreport.pdf](http://www.thecaq.org/docs/research/skepticismreport.pdf)

KPMG (2013) *Summary of the KPMG Professional Judgement Framework Understanding and Developing Professional Judgement in Auditing and Accounting* available at <https://university.kpmg.us/content/dam/kpmg-univ/prof-judgement/KPMG-UC-ProfJudg-Summary.pdf>

IFAC (2004) *IES 3 Initial Professional Development – Professional Skills*, in particular (b) ii and iv and (c) (Applying Professional Scepticism) available at <http://www.ifac.org/publications-resources/ies-3-initial-professional-development-professional-skills>

Plumlee, D, Rixom, B.A, and Rosman A.J. (2012) *Training Auditors to Think Sceptically*, draft paper prepared for 2012 University of Kansas Audit Symposium, supported by a grant from the Center for Audit Quality (CAQ)

Tversky, A. and Kahneman, D. (1974). *Judgement under uncertainty: Heuristics and biases*, *Science*, 185(4157), 1124-1131 available at <http://people.hss.caltech.edu/~camerer/Ec101/JudgementUncertainty.pdf>