

# Auditors' Professional Skepticism: Its Characteristics and Importance

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**Abstract :** Professional skepticism is an essential feature of contemporary audits. And it is an important term that appears throughout auditing standards and important concept in audit practice. Professional skepticism plays a fundamentally important role in the audit, and forms an integral part of the auditor's skill set. The purpose of this paper is to synthesize research related to auditors' professional skepticism and indicate major characteristics and importance of such an attitude. In this study I examine six skeptical characteristics that are particular importance for auditors. These characteristics are discussed next along with the associated findings of prior empirical auditing studies.

Keywords: professional skepticism, auditors' professional skepticism, auditor judgment, skeptical behavior.

## 1.INTRODUCTION

According to the glossary of the IAASB Handbook (2008), professional skepticism is 'an attitude that includes a questioning mind and a critical assessment of evidence'. It is important to study professional skepticism because if there would have been more skepticism on the side of the auditor this could have reduced the effects of major recent business 'improprieties' (cf., Bell et al., 2005). For example, the Enron-scandal is considered to be an audit failure as a result of not applying a suitable level of professional skepticism (e.g., Benston and Hartgraves, 2002, p. 122). Furthermore, Beasley et al., (2001, p. 65) found the lack of an appropriate level of professional skepticism to be number 3 (60% of the cases) among the top 10 list of audit deficiencies associated with fraud-related SEC cases. Number 1 on the list was gathering insufficient audit evidence (80% of the cases), which may also considered to be an element of professional skepticism (cf., Hurtt, 1999, 2007; and Hurtt et al., 2003, 2008). Also in the report of the Panel on Audit Effectiveness, an analysis of SEC Accounting and Auditing Enforcement Releases concludes that auditors appeared to have demonstrated a lack of sufficient professional skepticism in many of the situations studied (POB, 2000, p. 227). Such situations are harmful to the quality of audits and the reputation of auditors (cf., Carpenter et al., 2002, p.1). There is widespread agreement on the importance of professional skepticism in audit practice (see e.g., Hurtt et al., 2003, p.2; Nelson, 2009; Bell et al., 2005). Society trusts financial auditors to exercise professional skepticism in conducting the audit (e.g., Kadous, 2000; Kopp et al., 2003). Therefore, professional skepticism is an essential feature of contemporary audits. Despite its importance, there exists no consensus on the definition and measurement of professional skepticism (e.g., Hurtt et al., 2003; Nelson, 2009). Also there is criticism that auditing standards need to provide better guidance on how to implement the concept of professional skepticism (POB, 2000, p. 85; Pany and Whittington, 2001, p. 404). The recognized importance of professional skepticism, the lack of clarity concerning definitions and the need for more guidance warrant the need for research that explores the concept of professional skepticism in depth. However, only limited research on this topic has been conducted to date (Hurtt et al., 2003).

## II. DEFINITION OF PROFESSIONAL SKEPTICISM

Professional skepticism is the personality of the internal auditors that use knowledge, experience, training, and skills in performing their profession in auditing to assess the gathering and the evaluation of evidence when confronted with red flags (Nelson, 2009; Hurtt, 2010; Fullerton & Durtschi, 2004).

Professional skepticism is a concept that is discussed frequently in professional standards, but with little precision. One perspective, introduced in SAS No.1, is what the Panel on Audit Effectiveness characterizes as the "neutral" view of skepticism (O'Malley 2000, 76). For example, SAS No.1 indicates that PS is a requirement of due professional care, and that PS is "an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses the knowledge, skill, and ability called for by the profession of public accounting to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence ... The auditor neither assumes that management is dishonest nor assumes unquestioned honesty" (AU 230.07-09). In other words, the auditor works hard to gather and evaluate evidence, but does not assume any bias ex ante. Similar wording appears in international auditing standards (IAASB 2004, ISA 200.15-16). The PCAOB invokes this definition in AS No.2 (PCAOB 2004, para. 36), and other U.S. standards invoke this definition of PS while referencing the definition provided in AU 230. For example, regarding confirmations, SAS No.67 indicates that "the auditor should exercise an appropriate level of professional skepticism throughout the confirmation process. Professional skepticism is important in designing the confirmation request, performing the confirmation procedures, and evaluating the results of the confirmation procedures" (AU 330.15). More generally, SAS No. 109 highlights that "the auditor should plan and perform the audit with an attitude of professional skepticism" (SAS No. 109.19).

### III. PROFESSIONAL SKEPTICISM IN THE AUDITING STANDARDS

Professional skepticism is an important term that appears throughout auditing standards. The detailed genesis of the concept of 'professional skepticism' in auditing standards is not determinable. It appears to have been first used in SAS No. 16 (1977, the predecessor standard to SAS No. 53), was reinforced by SAS 82 in 1997 (Cushing, 2000, p. 1) and superseded by SAS 99 in 2002. The focus of all these standards is on considering fraud in a financial statement audit. As an alleged consequence of the US standards, IFAC introduced the concept of professional skepticism into ISA 240 at the start of this century. The apparent rationale behind the changes in the auditing pronouncements is the conjecture that the exercise of professional skepticism during the auditing process will improve the effectiveness of audits with respect to prevention and detection of fraudulent financial reporting (Cushing, 2000, p.1).

According to the standards (IFAC, 2008), the auditor should obtain sufficient appropriate evidence about whether the subject matter information is free of material misstatement. In doing so, the auditor should plan and perform an audit with an attitude of professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated (ISA 200:15). More specifically: an attitude of professional skepticism means that the auditor makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance (ISA 200:16). When making inquiries and performing other audit procedures, the auditor is not satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion (ISA 200:16).

ISA 240:24 states that an auditor should recognize the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience with the entity indicating the honesty and integrity of management and those charged with governance. ISA 240:23 stresses that due to the characteristics of fraud, the auditor's attitude of professional skepticism is particularly important when considering the risks of material misstatement due to fraud. Furthermore, with respect to those charged with governance, maintaining an attitude of professional skepticism means that the auditor carefully considers the reasonableness of responses to inquiries of those charged with governance, and other information obtained from them, in light of all other evidence obtained during the audit (ISA 240:25). When evaluating management's responses to inquiries, the auditor maintains an attitude of professional skepticism recognizing that management is often in the best position to perpetrate fraud. Therefore, the auditor uses professional judgment in deciding when it is necessary to corroborate responses to inquiries with other information. When responses to inquiries are inconsistent, the auditor seeks to resolve the inconsistencies (ISA 240:42).

### IV. DIRECTION OF PROFESSIONAL SKEPTICISM

The literature and auditing standards are equivocal on whether professional skepticism entails a 'neutral' stance or mirrors 'presumptive doubt' (see e.g., Nelson, 2009). A neutral stance refers to the fact that the auditor assumes no bias in management's representations *ex ante* (Nelson, 2009). For example, Cushing (2000, p. 2) states that skeptical auditors should attempt to be unbiased in forming their beliefs; there should be no bias in either a positive ('trusting') or negative ('suspicion') direction. Nelson (2009) argues that this is the basic idea underlying auditing standards.<sup>10</sup> In contrast, presumptive doubt takes a different view as used by forensic experts (e.g., POB, 2000, p. 88; Bell et al., 2005). Bell et al. (2005) assert that an auditor assumes some level of dishonesty by management unless evidence indicates otherwise. This view is consistent with that of forensic auditors who generally assume dishonesty unless there is evidence to the contrary (POB, 2000, p. 76). The Panel on Audit Effectiveness recommends that auditors adapt the view used by forensic experts (POB, 2000, p. 88) and proposes a 'forensic-type fieldwork' phase of the audit. Similarly, McMillan and White (1993) state that professional skepticism entails 'conservative bias' and 'conservative behavior' in audit judgments, implying that skeptical auditors will focus on error-related evidence (cf., Smith and Kida, 1991).<sup>11</sup> This presumptive doubt perspective is visible in the auditing standards concerning fraud (e.g., ISA 240), since those standards focus on the possibility of an intentional material misstatement due to fraud. In sum, there appear to be two directions of skepticism. However, according to Bell et al. (2005) there is a societal shift from the neutral stance perspective towards the presumptive doubt perspective of professional skepticism. They argue that this shift is caused by economic down turns and major business 'improprieties'.

### V. CHARACTERISTICS OF PROFESSIONAL SKEPTICISM

There is no universally accepted definition of professional skepticism (see e.g., Hurtt, 2007; Nelson, 2009; Doucet and Doucet, 1996). Several studies have focused on traits that skeptical auditors possess. Many studies concerning the traits of auditor skepticism use the skepticism scale developed by Hurtt (2010) (the Hurtt Professional Skepticism Scale; hereafter, HPSS), which measures trait skepticism using a scale composed of six characteristics:

- (1) Questioning mind,

- (2) Suspension of judgment,
- (3) Search for knowledge,
- (4) Interpersonal understanding,
- (5) Autonomy, and
- (6) Self-esteem.

Other studies use scales designed to measure trust and have equated a lower trust score with skepticism (e.g., Rose 2007; Quadackers et al. 2011). Hurr (2010, 150) describes skepticism as “a multi-dimensional individual characteristic. As an individual characteristic, professional skepticism can be both a trait (a relatively stable, enduring aspect of an individual) and also a state (a temporary condition aroused by situational variables).”

The first three characteristics of professional skepticism (a questioning mind, suspension of judgment, search for knowledge) relate to the way an auditor examines evidence. All three indicate a willingness to search for and fully examine sufficient evidence before making a decision. An auditor who exhibits professional skepticism is willing to wait to make a judgment, and as stated in SAS No. 1, “should not be satisfied with less than persuasive evidence” (AU 230.09; PCAOB 2006a). The fourth characteristic, interpersonal understanding, identifies the need to also consider the human aspects of an audit when evaluating evidence as is indicated in SAS No. 99’s (AICPA 1997b) instruction, “the auditor may identify events or conditions that indicate incentives/pressures [on individuals] to perpetrate fraud, opportunities [for individuals] to carry out the fraud, or attitudes/rationalizations [used by individuals] to justify a fraudulent action” (AU 316.31; PCAOB 2006b). The last two characteristics, self-esteem and autonomy, address the ability of the individual to act on the information obtained. Mautz and Sharaf (1961, 35), in their classic AAA monograph, *The Philosophy of Auditing*, discuss this, stating “(the auditor) must have the professional courage not only to critically examine and perhaps discard the proposals of others, but to submit his own inventions to the same kind of detached and searching evaluation.”

### 1. Questioning Mind (Questioning)

There seems to be no doubt that one aspect of professional skepticism is a questioning mindset. SAS No. 82 (AICPA 1997a) and SAS No. 99 (AICPA 2002) both indicate that professional skepticism is an attitude that “includes a questioning mind.” In fact, SAS No. 99 specifically increased the focus on professional skepticism as compared to previous standards by indicating that “professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred” (AICPA 2002, 13). Many accounting studies equate skepticism with suspicion, disbelief, or doubt, all of which have some aspect of this questioning construct (for a comprehensive review of professional skepticism literature, see Nelson 2009).

Research in consumer behavior also seems to indicate that skepticism entails questioning. This is especially true of the research stream that deals with skepticism about advertising (e.g., Ford et al. 1990; Koslow 2000; Mangleburg and Bristol 1998; Obermiller and Spangenberg 1998). Obermiller and Spangenberg (1998), in their scale to measure consumer skepticism of advertising, suggest that one aspect of skepticism is a tendency to question advertisers’ claims. Communications researchers discuss the concept of media skepticism, the extent to which individuals question or discount the information provided by the mass media (e.g., Cozzens and Contractor 1987; Irving and Berel 2001; Irving et al. 1998). This research on media skepticism indicates that obtaining information from known sources such as friends and family increases questioning about the information obtained from unknown sources such as the media.

Thus, the characteristic of a “questioning mind” as an aspect of skepticism is widely supported from accounting standards, accounting research, and research in many other disciplines.

### 2. Suspension of Judgment

The second aspect of professional skepticism is the characteristic of withholding judgment until there is an appropriate level of evidence on which to base a conclusion. Statement on Auditing Standards No. 1 (AICPA 1997b) discusses using due professional care in the performance of work, and makes several references to gathering sufficient evidence and waiting for persuasive evidence before making a judgment. In AU 230.9, this is stated as “the auditor should not be satisfied with less than persuasive evidence.” With the standards stating that professional skepticism mandates gathering and objectively evaluating evidence throughout the audit, this supports the concept that judgments must be suspended until sufficient evidence is obtained. Mautz and Sharaf (1961, 22) discuss the attitudes involved in effective auditing and indicate that an auditor must arrive at judgments only after evaluating evidence that is reasonably available. Suspension of judgment is also a necessary ingredient of skeptical inquiry according to writings in philosophy (Hallie 1985; Kurtz 1992). McGinn (1989, 6) states, “The skeptic takes up a reflective stance compared to our ordinary

practice of making and accepting knowledge claims.”

Suspension of judgment is the basic trait of the skeptic when confronted with dogmatic assertions. This research indicates that a skeptic is willing to form a judgment, but he or she is slow to do so, and this suspension of judgment motivates the next characteristic, a search for knowledge.

### 3. Search for Knowledge

The characteristic, a “search for knowledge,” differs from the characteristic of a questioning mind because a questioning mind has some sense of disbelief or doubt, while the search for knowledge is more of a sense of general curiosity or interest. Skeptics are interested in knowledge in general and are not necessarily motivated to search simply to verify a specific conclusion or obtain specific information. This aspect of skepticism is evident in philosophy. Johnson (1978, 14) characterizes skeptics as ones who seek knowledge for knowledge’s sake, and Bunge (1991, 131) indicates that skepticism encourages a desire to investigate. Similarly, Mautz and Sharaf (1961, 19) indicate that auditing compels a driving curiosity and urge auditors to adopt an attitude of curiosity when performing audits.

The question of what stimulates an individual to search for more information is a question that also has been of interest to psychological researchers for over a century (Litman and Silvia 2006, 318). This desire for knowledge is usually discussed in terms of individual curiosity. Much of this research investigates curiosity as both a relatively stable individual difference and as a situationally dependent characteristic (e.g., Spielberger and Reheiser 2003; Litman and Silvia 2006). Curiosity is theorized to energize and stimulate one’s interest, and also to drive exploration and discovery (Litman and Silvia 2006, 319).

### 4. Interpersonal Understanding

These first three characteristics are associated with how an auditor evaluates evidence, but an important aspect of evaluating audit evidence is interpersonal understanding, which deals with understanding the motivation and integrity of the individuals who provide evidence. SAS No. 99 is explicit in identifying many incentives and opportunities available to client personnel to present misleading evidence or to commit fraud, and recommends recognizing the possibility for less than truthful communication (AU 316.87.A2–A3). In consumer behavior, Obermiller and Spangenberg (1998, 160) indicate that advertising skepticism consists not only of questioning the “literal truths of ad claims,” but also of questioning the “motives of the advertisers.” In psychology, research related to social competence (which is often described in terms of social skills and social interaction) seems to best capture this interpersonal aspect of professional skepticism (e.g., Helmreich and Stapp 1974).

Well-known philosophical writings on skepticism (Burnyeat 1983; Hallie 1985; Hookway 1990; Johnson 1978; Kurtz 1992; McGinn 1989; Popkin 1979) provide evidence that understanding people’s motivations and behaviors is a fundamental component of skepticism. The philosophers suggest that it is only by understanding people that a skeptic can recognize and accept that different individuals have different perceptions of the same object or event. Individuals’ motivations and perceptions can lead them to provide inaccurate, biased, or misleading information.

Unless the skeptic understands people, it is difficult to recognize the potential for bias that exists in information given by people, and it is difficult to detect when people might be intentionally providing misleading information. Once an individual’s assumptions or motivations are identified and understood, the skeptic has a basis for challenging or correcting mistaken assumptions.

### 5. Autonomy

AU 230.08 indicates that each auditor should objectively evaluate audit evidence to determine if the evidence is sufficient to render a judgment. This supports the characteristic of autonomy— when an auditor decides for him- or herself the level of evidence necessary to accept a particular hypothesis. Mautz and Sharaf (1961, 35) support the need for autonomy when discussing the need for an auditor to possess professional courage, stating, “[the auditor] must have the professional courage not only to critically examine and perhaps discard the proposals of others, but to submit his own inventions to the same kind of detached and searching evaluations.” They further indicate that “[t]he prudent practitioner will take all appropriate steps to remove from his own mind any doubtful impressions or unanswered questions” (Mautz and Sharaf 1961, 136). The skeptical auditor is concerned with his own determination of the veracity of claims and is less influenced by the beliefs or persuasion attempts of others. Philosophers also indicate that professional skepticism involves individual autonomy (i.e., self-direction and moral independence). McGinn (1989, 6) identifies a skeptic as one who does not easily accept the claims of others. The skeptic identifies contradictions and fallacies present in the evidence or in the claims presented by others (Kurtz 1992, 22) and undertakes additional investigation and evidence until he or she is personally satisfied (Bunge 1991).

### 6. Self-Esteem

Skepticism also necessitates a certain level of self-esteem. Hookway (1990, 234) recognizes the need for esteem in successful inquiry, and Lom (2001, 32) discusses this requisite self-esteem in terms of an inner calmness and a lack of disturbance or turmoil. In psychology research, self-esteem is characterized as feelings of self-worth and belief in one’s own abilities. Self-esteem was

found to be negatively related to persuasibility (McGuire 1968) and negatively related to susceptibility to normative influence (Clark and Goldsmith 2005). Boush et al. (1994, 167) indicate that those who are low in self-esteem lack the confidence to rely on their own judgments and suggest that self-esteem is called for to challenge persuasive attempts rather than simply accept what is presented. Self-esteem was also found to be positively correlated with advertising skepticism.

Self-esteem enables an auditor to resist persuasion attempts and to challenge another's assumptions or conclusions. This often necessitates face-to-face interactions and willingness on the part of the skeptic to explicitly identify and acknowledge explanations other than those offered by an evidence provider. Skepticism seems to entail some level of self-esteem that is necessary to take action to acquire sufficient evidence to assuage doubts or answer questions raised during the audit. Skeptics should possess a level of self-esteem that allows them to value their own insights at least as greatly as those of others (Linn et al. 1982).

Together, these six characteristics comprise trait skepticism and form the basis for developing a scale to allow researchers to identify auditors who possess more or less professional skepticism.

## VI. IMPORTANCE OF PROFESSIONAL SKEPTICISM

Professional skepticism plays a fundamentally important role in the audit, and forms an integral part of the auditor's skill set. It facilitates the appropriate exercise of professional judgment, particularly regarding decisions about:

- The nature, timing and extent of audit procedures to be performed to reduce the risk to an appropriate level;
- Whether sufficient appropriate audit evidence has been obtained and whether more needs to be done to achieve the objectives of the relevant assurance standards;
- The evaluation of management's judgments (particularly regarding the application of the entity's applicable financial reporting framework in the context of an annual audit);
- The drawing of conclusions based on the audit evidence obtained.

The application of professional skepticism enhances the effectiveness of an audit procedure and of its application and reduces the possibility that we might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

## CONCLUSION

Professional skepticism is a foundation of the auditing profession that we need to maintain and evolve to support the audit of the future. Professional skepticism is at the heart of what auditors do: without it, the audit has little value, but the urge to use lack of skepticism as a catch-all classification for anything that is wrong in auditing or financial reporting, should be resisted. Professional skepticism is considered to be fundamental to the performance of a high-quality audit. Research studies suggest that professional skepticism can influence auditor's judgment and also auditor's actions. Most research focus on auditors' judgment, however regulators focus mostly on auditors' actions and procedures. It seems that filling the gap between these two dimensions of professional skepticism needs to be addressed to in future research. Other area of studies provides evidence that professional skepticism allows auditors to identify more fraud cues, expand budgeted audit hours, identify more contradictions, generate more alternative explanations, and negotiate more forcefully with a client. However, they are in most cases limited to the actions that auditors actually take related to their professional skepticism instead of traits that need to be exercised in order to retain high level of professional skepticism while performing audit procedures. It is suggested to focus more in future research onto the important aspects of the skeptical traits.

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