

PRACTITIONER SUMMARY

Enhancing Auditor Professional Skepticism: The Professional Skepticism Continuum

Steven M. Glover and Douglas F. Prawitt

SUMMARY: This summary is based on a paper by [Glover and Prawitt \(2013\)](#) that was commissioned and published by the Standards Working Group of the Global Public Policy Committee, a working group that comprises the six largest international audit networks. The application of professional skepticism by auditors is important to audit quality. However, various definitions of, and perspectives on, professional skepticism exist in the auditing literature. We propose a “professional skepticism continuum” that acknowledges that the appropriate application of professional skepticism will depend on the risk characteristics of the account and assertion. We also lay out the different structural levels where professional skepticism is applied and where threats to its appropriate application can arise. We argue that regulation can actually threaten the appropriate application of auditor skepticism if regulation and/or inspection focus is not properly aligned with relevant audit risks. Finally, we provide some ideas and recommendations on how the application of professional skepticism might be enhanced on the part of auditors, as well as how other key stakeholders can contribute to its effective application.

Steven M. Glover and Douglas F. Prawitt are both Professors at Brigham Young University.

We thank the CAQ and the Standards Working Group of the GPPC for their ideas and input through the process of preparing and revising. We also thank J. Gregory Jenkins and Dorsey Baskin (*CIIA* editors) for their insights and helpful comments in the review process. We gratefully acknowledge the assistance of Landon Bodily and Tyler Campbell in the preparation of the original 2013 monograph by Professors Glover and Prawitt titled *Enhancing Auditor Professional Skepticism* (<http://www.thecaq.org/docs/research/skepticismreport.pdf>) and the assistance of Brian Lowe in preparing this summary. Professors Glover and Prawitt gratefully acknowledge funding from the GPPC and from the Skousen and Glen Ardis endowed professorships, respectively, at Brigham Young University.

Submitted: March 2014

Accepted: June 2014

Published Online: August 2014

DEFINITION AND APPLICATION OF PROFESSIONAL SKEPTICISM

In providing a reasonable assurance report on a company's financial statements, the auditor must adhere to professional standards, which call for the appropriate application of professional skepticism. We note that while the concepts underlying professional skepticism are relatively straightforward, there is a lack of common understanding or practical guidance on what professional skepticism is and how it can be demonstrated and documented.

There is a heightened interest in the application of professional skepticism by auditors for a variety of reasons, including large-scale accounting frauds that were the catalyst for regulatory reform, such as the Sarbanes-Oxley Act; increasing complexity in transactions; the expanded use of subjective estimates and fair values in accounting, which require more judgment in estimating and evaluating the values reported in the financial statements; inspection findings that ascribe audit deficiencies to a lack of professional skepticism; and an ever-growing demand by users for reliability and trust in financial reporting.

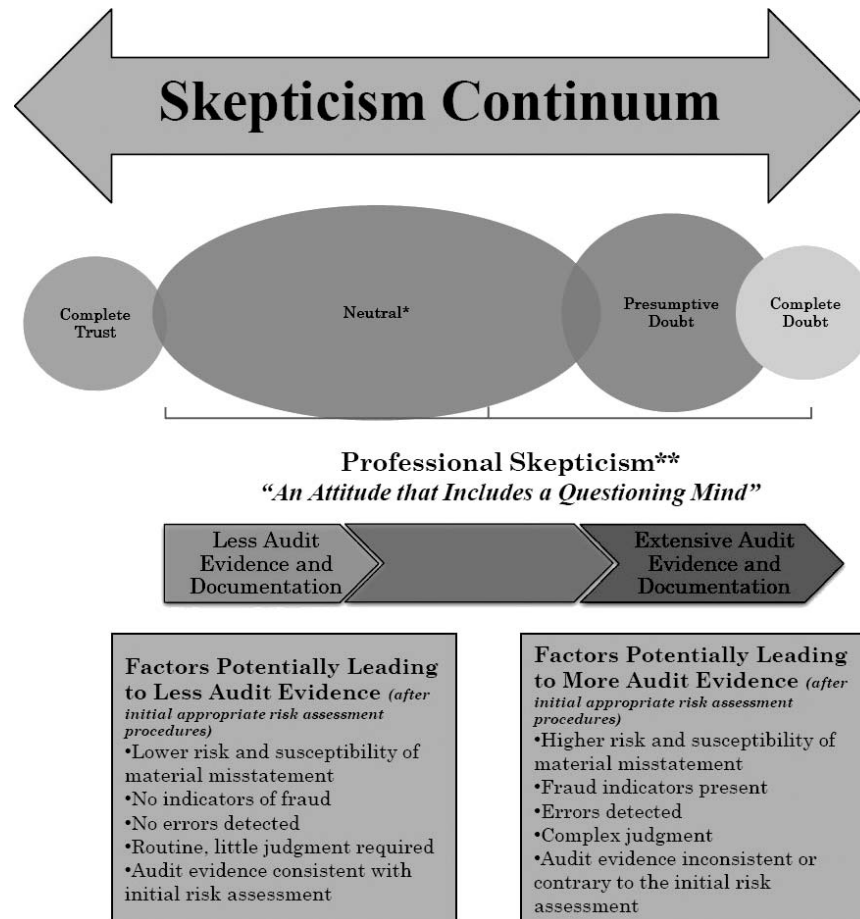
Inspection reports from regulators around the world often express concern with the application of professional skepticism. However, in order to enact measures to improve skepticism, there must be a better understanding of the concepts that underlie it and the factors at different structural levels that influence it. Recommendations that overlook important concepts and influences on professional skepticism may not yield incremental improvement in audit or financial reporting quality.

Skepticism comes from the Greek origin "skeptikos," meaning "inquiring or reflective." Being a skeptic is often associated with questioning, careful observation, probing reflection, and suspension of belief. Professional skepticism incorporates the attributes associated with being a skeptic to a professional setting that requires due diligence and a standard of care. When we examine the treatments of professional skepticism in U.S. and international auditing standards and in the academic literature, we find related but different definitions. For example, international and U.S. auditing standards stress a questioning mind and a critical assessment of audit evidence. However, these terms are somewhat ambiguous, and there is varied interpretation about what it means to demonstrate a questioning mind or critically assess audit evidence (see, [Nelson 2009](#)).

The academic literature seems to describe a range of perspectives when discussing skepticism. Some refer to the *presumptive doubt* view, which assumes some level of carelessness, incompetence, or dishonesty on the part of financial statement preparers. This seems consistent with the requirement in auditing standards to assume there are significant risks in revenue recognition, regardless of previous experiences with the company. In addition, [Nelson \(2009\)](#) indicates that regulators appear to take a presumptive doubt perspective in their inspections, as they typically refer to a lack of professional skepticism as a contributing factor to audit failure. However, [Nelson \(2009\)](#) notes that taking a presumptive doubt approach for the whole audit would result in over collection of audit evidence in many areas and result in a suboptimal balance of effectiveness and efficiency. Many areas in the auditing standards appear to take a *neutral* perspective. For example, "the auditor neither assumes that management is dishonest or assumes unquestioned honesty" (e.g., see [PCAOB 2003](#), AU 230.07–09; [AICPA 2012](#), AU 200.A26).¹ With this approach, the auditor carefully evaluates evidence but without presuming a high likelihood of misstatement in the account. Finally, although not in the professional literature, others have asserted that in some circumstances skepticism can involve a level of trust, accompanied by appropriate verification. We argue that instead of having to choose

¹ Similar wording appears in international auditing standards ([IAASB 2009](#), ISA 200.15–16).

EXHIBIT 1
The Application of Professional Skepticism



* Neutral—neither assuming management dishonesty nor unquestioned honesty.

** Professional Skepticism does not include the area of the continuum depicted by Complete Trust; in the area depicted as Complete Doubt, the auditor will move to a forensic mindset.

only one of these attitudes for the entire audit, it is important for the auditor to be able to take each perspective depending on the particular situation during the audit. For this reason, we propose the application of a professional skepticism continuum to the audit in hopes of helping auditors achieve the optimal balance between effectiveness and efficiency.

Exhibit 1 shows our proposed skepticism continuum. Such a continuum enables the auditor to take the perspective that is most appropriate considering the circumstances applicable to each audit area and assertion. It is important to keep in mind that applying such a continuum to a specific account and assertion takes place *after* a careful and rigorous initial risk assessment, and that the auditor continues to reevaluate risk throughout the audit to ensure that appropriate skepticism is applied to the collection and evaluation of audit evidence. We note that while the illustration includes a behavioral range from complete trust to complete doubt, the exhibit highlights that the application of professional skepticism does not include the area of complete trust. Nor does the continuum suggest that the collection of no audit evidence for accounts reported in the financial statement would be appropriate.

The use of a continuum makes clear that the appropriate level of skepticism varies depending on the situation. While Exhibit 1 illustrates different levels of professional skepticism, the continuum represents a gradation of more or less doubt within and across categories, and not necessarily completely different mindsets at distinct stages of the continuum. The exhibit lists factors that could lead to a more neutral or doubting perspective and thus the need for less or more audit evidence. The factors leading to the need to gather more or less audit evidence recognize that there will be circumstances when the auditor's risk assessment procedures will lead the auditor to determine that different amounts of audit effort are necessary for a particular account or assertion. For example, an asset account balance that is clearly immaterial would not require additional work beyond gathering evidence for and performing the initial risk assessment. An initial risk assessment that leads to a particular skepticism level should be reevaluated and challenged based on evidence obtained throughout the audit to determine if the original assessment is still appropriate. The maintenance of a questioning mind is associated with the entire range of professional skepticism and the auditor should always be alert for, and follow up on, issues that could result in the need for more audit evidence. On one hand, there is evidence that this is difficult for auditors in view of the fact that one of the more common inspection findings is a lack of professional skepticism (e.g., see, [PCAOB 2013](#), Release No. 2013-001; [PCAOB 2008](#), Release No. 2008-008). On the other hand, there is evidence that inspectors may have difficulty applying the continuum—recent academic research suggests that inspectors may inappropriately focus on lower-risk areas, may not appropriately consider misstatement risk and the totality of audit evidence gathered, and may expect more evidence than auditing standards require ([Glover, Taylor, and Wu 2014](#)).

We suggest that the consistent application of appropriate professional skepticism would be enhanced if all parties were to integrate a skepticism continuum conceptually similar to the one illustrated in Exhibit 1, and then work to provide relevant practical implementation guidance. Such guidance would acknowledge appropriate differences in the application of professional skepticism and the appropriate differences in the nature and extent of audit evidence necessary across the continuum.

THREATS, MITIGATING FACTORS, AND SUGGESTIONS TO ENHANCE THE APPLICATION OF PROFESSIONAL SKEPTICISM

Some regulators have suggested that the application of appropriate professional skepticism might have helped firms avoid alleged audit deficiencies.² We fully support efforts to improve the application of professional skepticism. However, we believe that unless all parties fully understand the various factors that can affect the application of professional skepticism, we may find ourselves with “solutions” that fail to address underlying problems and whose costs outweigh the benefits.

A key to addressing factors that may enhance professional skepticism is to recognize that different factors become relevant at different structural levels of the professional setting. We break these structural levels into the following categories: individual auditor, engagement team, audit firm, and overall audit profession. In order to implement effective and efficient measures to enhance professional skepticism, proposed solutions should consider how they will affect each

² For example, as noted by [Nelson \(2009\)](#), former SEC Chief Accountant George Diacont asserted that a lack of professional skepticism is a primary cause of audit failure ([Carmichael and Craig 1996](#)), and a lack of auditor skepticism has been identified as both contributing to the majority of the SEC enforcement actions ([Beasley, Carcello, and Hermanson 2001](#)), and to malpractice claims against auditors ([Anderson and Wolfe 2002](#)).

structural level and take into account both the nature of the threats in each level and the mitigating factors already in place. In fact, we argue that regulation can threaten the appropriate application of auditor skepticism if regulation and/or inspection focus is not properly aligned with relevant audit risks. In other words, if auditors are required to expend effort to manage “inspection risk” in areas that are not sufficiently correlated with risk of material misstatement for a specific engagement, then the influence of the inspection process can result in misplaced focus and effort, and potentially less attention to areas that present greater audit risk.

Appendix A illustrates the different structural levels along with some of the threats and mitigating factors affecting each level. The appendix also provides suggestions for enhancing the application of professional skepticism at the three levels. The purpose of Appendix A is to highlight the differences between threats, mitigating factors, and suggestions for improvement at each different structural level; hence, the importance of looking at proposed measures to improve professional skepticism through the lenses of the different levels. The lists in Appendix A are not intended to be comprehensive and the items listed in each structural level may be appropriately included in or affect other levels. As the parties involved take into consideration the threats, mitigating factors currently in place, and suggested next steps at each of the different structural levels, they will be better able to formulate policies that affect real areas of need and contribute to improved application of professional skepticism.

WHAT CAN OTHER STAKEHOLDERS IN THE FINANCIAL REPORTING PROCESS DO TO ENHANCE AUDITOR PROFESSIONAL SKEPTICISM?

External auditors clearly have the responsibility to apply appropriate professional skepticism throughout an audit. They, along with boards of directors, audit inspectors/regulators, and audit standard setters, have an interest in ensuring that financial statements are fairly presented. This section summarizes some of the ways in which outside stakeholders can contribute to the consistent and fair application of professional skepticism by auditors.

The board of directors’ main tool for contributing to the quality of the audit process, including the application of professional skepticism, is more effective use of the audit committee. We suggest that today’s climate demands that audit committees strengthen their independence and financial reporting expertise. It must be made clear within the organization that the audit team is employed by the audit committee, not management. The audit committee must have the expertise and commitment to ask probing questions of management and the external auditor. Audit committees should promote a culture of professional skepticism by challenging the judgments of both management and auditors and encouraging all parties to look at all the potential evidence (both confirming and disconfirming) when decisions need to be made. Audit committees should also ensure that the auditor is paid an appropriate audit fee, as recent research suggests that adequate audit fees are an important component of audit quality (Christensen, Glover, Omer, and Shelley 2014).

Regulators, inspectors, and standard setters also have a responsibility to contribute to the consistent application of professional skepticism. The most pressing need is to include an accepted judgment framework and skepticism continuum in auditor and inspector training and practice. The lack of a common definition and shared understanding limits the ability to both apply and to evaluate the application of appropriate professional skepticism. Standard setters, regulatory bodies, and the profession should work in concert to integrate the key concepts of a professional

judgment framework and skepticism continuum into auditing standards. The revised standards would help auditors link the appropriate level of professional skepticism with the appropriate nature, timing, and extent of evidence in relation to the risk of material misstatement. Over time, the development of a common understanding in these areas will facilitate regulation, standard setting, and inspection that could significantly enhance the application and assessment of professional skepticism in practice.

Academics clearly can contribute to the profession's efforts to enhance auditor professional skepticism. A growing body of research on auditor skepticism exists in the academic literature that adds significantly to our understanding of the antecedents, processes, and consequences of the application of auditor skepticism (see [Hurt, Brown-Liburd, Earley, and Krishnamoorthy \[2013\]](#) for a review and synthesis of this literature). However, further research could inform practice with respect to the effects of training and implementation of a professional judgment framework and a skepticism continuum on auditors' ability to effectively apply skepticism in practice, to identify roadblocks to the appropriate application of skepticism, and to develop best practices for boosting judgment and skepticism. Academics can also identify ways to help accounting students, as well as practicing auditors, develop their sense of professional skepticism and hone related skills. Research could assist in identifying the most effective ways to encourage and develop students' and practitioners' ability to apply appropriate skepticism, given different backgrounds and personal traits. We believe it is important for academics to engage with the profession and contribute to this important and potentially fertile area of inquiry.

CONCLUSION

Due to past high-profile audit failures, reported audit deficiencies in regulator inspection reports, and the growing number and size of complex estimates in the financial statements, there is a growing need for reliability and trust in financial reports and a corresponding increased demand for enhanced audit quality. Enhancing the level of professional skepticism applied in practice is one important means of improving audit quality, but there is a lack of practical guidance around the appropriate application and documentation of professional skepticism in the professional literature. A shared understanding would allow audit professionals to identify, communicate, and exercise a level of professional skepticism appropriate for the risks involved, and would enable regulators to fairly evaluate, after the fact, the level of skepticism applied. The skepticism continuum we propose represents a potential step forward in understanding the nature of professional skepticism and in applying it appropriately under varying circumstances. In order to make the necessary changes, the profession, academics, regulators, and standard setters should work together to better understand the nature of professional skepticism, including how skepticism is threatened at various structural levels, current measures in place to mitigate those threats and, then, finally, how skepticism can be enhanced at the various structural levels. Our hope is that this paper will provide a conceptual foundation to facilitate a productive ongoing dialogue that will lead to specific actions to enhance auditor professional skepticism and, ultimately, audit quality.³

³ The GPPC distributed the full monograph on which this summary is based to various stakeholders in Europe. The monograph is also available for free download on the Center for Audit Quality's website ([http:// www.thecaq.org/docs/research/skepticismreport.pdf](http://www.thecaq.org/docs/research/skepticismreport.pdf)). The skepticism continuum proposed in the monograph, as summarized in this paper, was discussed in recent panels involving board members of the PCAOB at both the 2013 AAA Annual Meeting and the 2014 Kansas Auditing Symposium.

REFERENCES

- American Institute of Certified Public Accountants (AICPA). 2012. *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*. AU-C Section 200. Available at: <http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-C-00200.pdf>
- Anderson, S., and J. Wolfe. 2002. A perspective on audit malpractice claims. *Journal of Accountancy* 194 (3): 59–66.
- Beasley, M. S., J. V. Carcello, and D. R. Hermanson. 2001. Top 10 audit deficiencies. *Journal of Accountancy* 191 (4): 63–66.
- Carmichael, D. R., and J. L. Craig, Jr. 1996. Proposal to say the “F” word in auditing standards. *The CPA Journal* 66 (6): 22.
- Christensen, B. E., S. M. Glover, T. C. Omer, and M. K. Shelley. 2014. *Understanding Audit Quality: Insights from Audit Partners and Investors*. Working paper, Brigham Young University, Texas A&M University, and University of Nebraska.
- Glover, S. M., and D. F. Prawitt. 2013. *Enhancing Auditor Professional Skepticism*. Available at: <http://www.theaca.org/docs/research/skepticismreport.pdf>
- Glover, S. M., M. H. Taylor, and Y.-J. Wu. 2014. *Closing the Gap between Auditor Performance and Regulators’ Expectations when Auditing Fair Value Measurements: Evidence from Practicing Audit Partners*. Working paper, Brigham Young University and Case Western Reserve University.
- Hurt, K. R., H. Brown-Liburd, C. E. Earley, and G. Krishnamoorthy. 2013. Research on auditor professional skepticism: Literature synthesis and opportunities for future research. *Auditing: A Journal of Practice & Theory* 32 (1): 45–97.
- International Auditing and Assurance Standards Board (IAASB). 2009. *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*. ISA 200. Available at: <http://www.ifac.org/sites/default/files/downloads/a008-2010-iaasb-handbook-isa-200.pdf>
- Nelson, M. W. 2009. A model and literature review of professional skepticism in auditing. *Auditing: A Journal of Practice & Theory* 28 (2): 1–34.
- Public Company Accounting Oversight Board (PCAOB). 2003. *Due Professional Care in the Performance of Work*. AU Section 230. Available at: http://pcaobus.org/Standards/Auditing/Pages/AU230.aspx#ps-pcaob_1c410f9b-5033-4f18-b865-af1307863bee
- Public Company Accounting Oversight Board (PCAOB). 2008. *Report on the PCAOB’s 2004–2007 Inspections of Domestic Firms Annually Inspected*. Release No. 2008-008. December 5. Washington, DC: PCAOB.
- Public Company Accounting Oversight Board (PCAOB). 2013. *Report on 2007–2010 Inspections of Domestic Firms that Audit 100 or Fewer Public Companies*. Release No. 2013-001. February 25. Washington, DC: PCAOB.

APPENDIX A

Illustration of Threats and Factors in Place and Suggestions to Enhance Professional Skepticism by Structural Level

Individual Auditor

Pertains to each individual auditor on any given engagement.

Threats

Some of the potential threats to professional skepticism that may exist at the Individual Auditor level include:

- Judgment traps and biases, lack of knowledge and expertise
- Deadline pressure, inherited preferences, and expectations
- Auditor character, and personal and cultural attributes
- Performance and compensation metrics and incentives that do not appropriately encourage professional skepticism

Mitigating Factors

Some of the measures in place to foster and encourage the appropriate application of professional skepticism at the Individual Auditor level include:

- Professional licensing and continuing education requirements
- Supervision, mentoring, review, and inspection of work and performance evaluations
- Effective planning and audit programs, including expectation setting
- Performance metrics that reward people for high-quality work
- Stringent recruiting requirements
- Effective engagement partner and leadership messaging
- Training on core competencies, professional judgment, and other subjects

Suggestions to Enhance

Some of the measures that could be taken to enhance the appropriate application of professional skepticism at the Individual Auditor level include:

- Training in, and the application of, a good judgment process to avoid and mitigate traps and biases. A common and formal judgment framework provides a consistent, logical approach to ensuring that judgments are well considered and provides a shared vocabulary.
- Proactively identifying and applying different judgment frames will improve auditors' ability to have a questioning mindset and appropriately and effectively challenge assumptions and explanations.
- Align performance evaluation and incentives so that the appropriate application of professional skepticism is evaluated positively and rewarded.

Engagement Team

Pertains to each engagement team assigned to a specific client.

Threats

Some of the potential threats to professional skepticism that exist at the Engagement Team level include:

- Client service and business development goals that create conflict of interest
- Inadequate time management, limited resources, and ineffective utilization of specialists and experts
- Misaligned inspection influence (e.g., expanded requirements)
- Preferences of management and partner, tone or practices of engagement leadership that do not adequately emphasize professional skepticism
- Apprenticeship model
- Client characteristics (governance structure, tone at the top)
- Familiarity linked to audit tenure
- Potential bias stemming from Groupthink tendencies

Mitigating Factors

Some of the measures in place to foster and encourage the appropriate application of professional skepticism at the Engagement Team level include:

- Planning with involvement of engagement leadership
- Industry and client experience
- Fraud brainstorming meetings

- Internal quality performance review programs
- Required upward consultation
- HR and independence policies, including limitations on provision of certain nonaudit services and restrictions on compensation based on such services
- Ethics and compliance hotlines
- Partner rotation requirements
- Engagement quality control review and external inspection programs

Suggestions to Enhance

Some of the measures that could be taken to enhance the appropriate application of professional skepticism at the Engagement Team level include:

- Engagement leader sets the tone for the engagement team that an appropriate level of professional skepticism is expected and valued.
- Mitigate the limitations of the apprenticeship model, such as an “understanding” rather than a “challenging” mindset, through more effective review and coaching techniques based on a shared vocabulary.
- Structure group decisions to avoid Groupthink tendencies.
- Focus specifically on skepticism in internal oversight, review, and on-the-job training. For example, in addition to current engagement quality review processes, instigate real-time reviews of ongoing engagements to evaluate the application and documentation of professional skepticism.

Profession/Audit Firm

Pertains to the external auditing profession; encompasses public accounting firms and the economic and regulatory environment in which they operate.

Threats

Some of the potential threats to professional skepticism that exist at the Profession/Audit Firm level include:

- Conflicts of interest stemming from the payor/selector model
- Insufficient resources devoted to the audit, or competition primarily based on audit fees
- Incentives created by office/regional performance measures and consequences
- Dependency by local office on a large client
- Nature or volume of nonaudit services
- Inspection focus that does not fully align with relevant audit risks
- Audit committees that do not understand the oversight role or are aligned too closely with management

Mitigating Factors

Some of the measures in place to foster and encourage the appropriate application of professional skepticism at the Profession/Audit Firm level include (may differ by jurisdiction):

- Tone at the top encouraging high-quality auditing and professional skepticism
- Independence requirements, including prohibition on providing certain nonaudit services
- Licensing exams, experience, and continuing education requirements
- Professional accounting and auditing standards

- Audit methodology, templates, tools, and policies, including linkage between assertions and audit procedures
- Quality control policies and procedures, including internal and peer inspections, and independence policies, tracking, and enforcement
- Independent regulatory oversight and inspection, and appropriate public reporting of inspection results
- Required upward consultations
- Threat of litigation, sanction, fine
- Quality control, quality reviews, and independence standards
- Required communication with the audit committee, audit committee selecting and appointing the auditor, and audit committee approval of nonaudit services

Suggestions to Enhance

Some of the measures that could be taken to enhance the appropriate application of professional skepticism at the Profession/Audit Firm level include:

- Consistently message a culture of consultation and the need and expectation for a questioning, probing mindset. Publicly acknowledge and highlight instances where the appropriate application of professional skepticism made a positive difference.
- Firms should develop and support a formal professional judgment framework and process.
- Develop and deliver training specifically focused on enhancing professional judgment and skepticism.
- Develop tools, templates, and technology to enhance and document the application of professional judgment and skepticism.