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May 15, 2016

International Auditing and Assurance Standards Board
529 5th Avenue
New York, New York 10017

Re: Invitation to Comment: Enhancing Audit Quality in the Public Interest

To Whom It May Concern:

I am delighted to have this opportunity to submit my thoughts on professional skepticism in response to the International Auditing and Assurance Standards Board (the "Board") Invitation to Comment ("ITC") and thank the Board for soliciting input on whether it should undertake a project to improve the application of professional skepticism in the audit. I am very interested in this subject and wrote an article on professional skepticism that was published in the January 2015 issue of The CPA Journal.

The IAASB could achieve a number of positive outcomes in this important area. I have outlined some important objectives of such a project, below, and have made several recommendations. I have done my best to organize my thoughts under the questions you pose in the ITC. I also suggest that you refer to my article, which I have also attempted to upload to your comment file.

PS1. Is your interpretation of the concept of professional skepticism consistent with how it is defined and referred to in the ISAs? If not, how could the concept be better described?

Response:

The language currently used in ISA 200 the auditing standards to describe professional skepticism is quite good. I also like the description provided in the PCAOB's AS 1015.07, which contains the essential elements of what it means to be skeptical. It states:

"Professional skepticism 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."

This language properly points to the objective of skepticism, that is, to "diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence." Supporting the independent, objective and critical evaluation of audit evidence is ultimately what the Board should strive for in any project on skepticism. The application material in ISA 200 also points in this direction.

There remain several opportunities to improve the discussion around professional skepticism.

Help to Improve the Clarity of Discussions About Professional Skepticism

When audit failures are discovered, we sometimes hear that the auditor “was not skeptical enough” or that the situation required “a higher level of professional skepticism” or that “the auditor’s skepticism should be enhanced.” I am guilty of the same thing, as is evidenced by some of the language I used in my article referenced above. This variation in the way skepticism is described is not helpful, and the Board has the opportunity to provide needed leadership in how this concept is discussed.

Eliminate Unneeded or Contradictory Guidance

A particular passage in some auditing standards sets the wrong tone. For example, the PCAOB’s standards include this passage, which is that, “The auditor neither assumes that management is dishonest nor assumes unquestioned honesty.”¹ This language apparently directs the auditor to be neutral. By definition, skepticism is not a neutral mindset. Merriam-Webster defines skepticism as, “an attitude of doubt or a disposition to incredulity either in general or toward a particular object.”²

The profession is aware of many instances in which management was dishonest. Although that does not mean the auditor should always assume management is dishonest, the auditor should accept that there always is a possibility that management is dishonest. Stating this fact in the auditing standards is appropriate and would be helpful.

Eliminate Passive Guidance and Direction

The ITC says that, “Professional skepticism includes being alert to, for example, audit evidence that contradicts other audit evidence obtained, or information that brings into question the reliability of documents or responses to inquiries to be used as audit evidence.” ISA 200 also uses this type of language. I do not believe that it is not strong enough to tell the auditor to be “alert.” A critical evaluation of audit evidence should include the auditor *actively* evaluating whether the evidence obtained is consistent with management’s assertions in the financial statements and with other audit evidence obtained.

In my The CPA Journal article, I recommended that auditors must “be alert” to contradictory audit evidence, etc. As discussed in the preceding paragraph, I now believe the Board should consider a more active approach to the guidance.

Keep Things Simple

A point of discussion is whether an auditor can and should *vary* the amount of professional skepticism applied depending on the facts and circumstances at hand, or whether, more simply, the auditor is either skeptical or he is not. It is not clear that this difficult question

¹ PCAOB, AS 1015.09.

² <http://www.merriam-webster.com/dictionary/skepticism>.

needs an answer, if the Board were to focus instead on what it expects auditors to do (that is, to objectively and critically evaluate all audit evidence obtained).

There has been at least one recommendation that auditors implement a professional skepticism continuum. The Board naturally will consider this idea if it undertakes a project in this area. I have serious doubts about whether such a continuum can be effectively understood and implemented and believe that it would not be helpful to place another layer of complexity over an already complex process.

Focus on Outcomes, What the Board Wants Auditors to Do

As the Board works through this project, it should remain focused on how the description of professional skepticism (including any related standards and guidance) will affect the auditor's behavior and attitude. The following are the types of auditor behaviors and attitudes that should be expected from an auditor who is appropriately skeptical:

- The objective and critical evaluation of all audit evidence obtained
- An understanding that there always is a possibility that audit evidence will be contradictory to management's assertions in the financial statements
- An understanding that there always is a possibility that the financial statements could be misstated due to fraud or error
- A continuous assessment of whether sufficient appropriate audit evidence has been obtained

PS2. What do you believe are the drivers for, and impediments to, the appropriate application of professional skepticism? What role should we take to enhance those drivers and address those impediments? How should we prioritize the areas discussed in paragraph 37?

Response:

The Principal Driver of Skepticism is Independence

Auditors must be *willing* to recognize when audit evidence is contradictory or inconsistent with management's assertions, and when additional audit evidence is needed. This is why an independent mental attitude ("independence of mind") is so important.

In the context of an audit, the concepts of independence and skepticism are very closely related. Accordingly, it is appropriate to discuss independence in connection with providing guidance on the application of professional skepticism. (Taken to an extreme, one might even argue that the concept of professional skepticism is unnecessary: independence of mind combined with an objective and critical evaluation of all audit evidence obtained should uncover contradictory audit evidence and identify the need for additional auditing procedures. I am not recommending this, however, as the notion of skepticism can help to foster an appropriate attitude.)

Impediments to Professional Skepticism

The PCAOB, in Staff Audit Practice Release No. 10, “Maintaining and Applying Professional Skepticism in Audits” (“SAPA 10”), identified a number of impediments to professional skepticism, including:

- incentives and pressures to build or maintain a long-term audit engagement, avoid significant conflicts with management, provide an unqualified audit opinion prior to the issuer's filing deadline, achieve high client satisfaction ratings, keep audit costs low, or cross-sell other services,
- over time, develop an inappropriate level of trust or confidence in management,
- feelings of pressure to avoid potential negative interactions with, or consequences to, individuals they know (that is, management), and
- scheduling and workload demands.

I believe the foregoing are significant impediments to the exercise of professional skepticism. Also, people may be predisposed to trust. As I discussed in my article, an academic study published in 2013 suggests that presumptive trust – a predisposition to believe interviewees – is the prevailing mental perspective of auditors, even when information available to the auditor suggests that there is a risk of deception.³ This finding is consistent with academic studies on deception detection, which provide abundant evidence that people tend to have a mindset of presumptive trust.⁴ Another academic study indicates that expectations are driven primarily by previous client experience; accordingly, because most auditors are not exposed to negative prior experiences, their natural traits prevail.⁵

PS3. Is the listing of areas being explored in paragraph 38–40 complete? If not, what other areas should we or the Joint Working Group consider and why? What do you think are the most important area to be considered?

Response:

The list of items included in paragraphs 37 through 40 is a good list. I do believe that care should be taken to avoid over-responding to this issue and providing too much guidance. I believe that providing clarity, as discussed in my response to your PS1, will go a long way in helping auditors to appropriately apply professional skepticism.

As discussed in my responses to the previous questions, I do not believe it is worthwhile to develop and publish a framework on professional skepticism. Rather, I believe it would be far more useful to describe what it means to exercise skepticism. A similar discussion about what it means to exercise professional judgment also might be helpful.

³ Lee, C., Welker, R. B., Wang, T., (2013) “An Experimental Investigation of Professional Skepticism in Audit Interviews”, *International Journal of Auditing*, Vol. 17, pp. 213-226.

⁴ Ibid.

⁵ Popova, V., (2013) “Exploration of Skepticism, Client-Specific Experience, and Audit Judgments”, *Managerial Auditing Journal*, Vol. 28, No. 2, pp. 140-160.

It would be useful to explore whether auditors should document their exercise of skepticism. In my article I made the following recommendation:

The audit partner on each audit engagement could be required, either by the audit firm as a matter of policy or by regulators as a part of professional standards, to document how the engagement team overcame each of [the] impediments [to skepticism] on the audit. For example, what steps did the audit partner and other engagement team members take to ensure the team was able to and did exercise sufficient skepticism in light of tight filing deadlines or strenuous workload demands? Is the engagement partner satisfied that the steps taken were sufficient? Did the engagement team work with client management to ensure that information was provided to the auditor with sufficient time to appropriately evaluate it? How did the team address the possibility that incentives or pressure to maintain or enhance the firm's relationship with the client would impair their judgment? What did the team do to resist developing an inappropriate sense of trust in management? Discussing these matters as a part of the audit engagement planning meeting also may enhance the professional skepticism exercised by engagement team members.

PS4. Do you believe the possible actions we might take in the context of our current projects relating to quality control and group audits will be effective in promoting improved application of professional skepticism? If not, why?

Response:

Yes, I believe changes, as discussed, below, in the systems of quality control of audit firms can help to improve the exercise of professional skepticism.

Tone at the Top. Perhaps most important to the appropriate exercise of professional skepticism is the tone set by top management of the audit firm that is carried down through the leadership ranks and embraced by the engagement partners. The partners and staff need to know they are expected to be skeptical and that their decisions to seek more evidence in response to their professional skepticism will be supported and rewarded. Communications from top management about audit quality must be substantive and sincere, and not overshadowed by communications on other firm goals, such as growth, profitability and maintaining or enhancing client relationships. Sharing examples of situations in which audit teams discovered important information through their exercise of professional skepticism may enhance these communications.

The PCAOB has recently recognized that some auditing firms have improved in this area.

Inculcate Skeptical Behavior. Auditing standards and academic research both acknowledge that the personal traits of the auditor are important to the auditor's ability to exercise professional skepticism. An academic study published in April 2010 by Baylor University Professor Kathy R. Hurrt identified six personal traits, or characteristics that define professional skepticism. These include a questioning mind, suspension of judgment, search for knowledge, interpersonal understanding, autonomy, and self-esteem. Educators, the profession and firms can all play a role in training and instilling these characteristics and

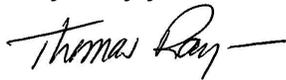
associated behaviors in auditing professionals. A recent academic study provides evidence that a course that emphasizes forensic accounting appropriately influences students' fraud-related judgments (e.g., it resulted in higher initial risk assessments relative to potential fraud risk factors and increased the students' skepticism) and that the trained students' improved performance could persist.⁶ This suggests that auditor can be trained to behave skeptically.

* * * * *

I was formerly Chief Auditor and Director of Professional Standards at the Public Company Accounting Oversight Board in Washington, DC, a national office partner with KPMG LLP, the Director – Audit and Attest Standards at the American Institute of Certified Public Accountants, and a former auditing practitioner with Grant Thornton LLP. I currently teach auditing at Baruch College, City University of New York.

Please do not hesitate to contact me if you would like clarification with regard to the contents of this letter. It was my pleasure to have this opportunity to provide input to the Board.

Very truly yours,

A handwritten signature in black ink that reads "Thomas J. Ray". The signature is written in a cursive style with a horizontal line extending to the right from the end of the name.

Thomas J. Ray

⁶ Carpenter, T. D., Durtschi, C., Milici Gaynor, L., (2011) "The Incremental Benefits of a Forensic Accounting Course on Skepticism and Fraud-Related Judgments", *Issues in Accounting Education*, Vol. 26, No. 1, pp. 1-21.

In
Focus



Auditors Still Challenged by Professional

Skepticism

*Recommendations for Firms, Standards Setters,
and Regulators*

By Thomas Ray

In Brief

Almost 40 years ago, the term “professional skepticism” was added to the audit literature as part of the process to improve the detection of accounting errors and irregularities. Fast forward to recent years, which have witnessed increased criticism from regulators that the accounting profession is not “skeptical enough.” This article provides a history and analysis of the concept of professional skepticism and recommends how to improve audit results in the future.

The assertion that auditors of financial statements should be skeptical seems redundant. Any awareness that the financial statements being audited could be misstated, either due to error or fraud, should prompt the auditor to seek and evaluate sufficient appropriate audit evidence critically. Recurring criticism that independent auditors are not exercising sufficient professional skepticism indicates that the problem has not been completely resolved. This article explores the nature of the criticisms, highlights some relevant academic research, and outlines several recommendations to auditors, audit firms, standards setters, and regulators.

fessional skepticism. Since then, other auditing standards amendments have established additional procedural requirements and provided guidance on how to exercise professional skepticism. Yet, in spite of numerous studies, articles and guidance documents issued on this fundamental requirement, auditors continue to be criticized for not exercising sufficient professional skepticism.

PCAOB Sounds the Alarm and Criticisms Mount

In December 2012, concerned by the evidence obtained in its inspections of registered public accounting firms, the Public Company Accounting Oversight Board

a lack of professional skepticism was at least a contributing factor:

- Acceptance of client-prepared analyses or management's explanations without obtaining evidence to corroborate management's assertions, including cases in which known or reasonably available contradictory audit evidence was not evaluated or obtained by the auditors.

- Insufficient testing of the completeness and accuracy of source documents, and

- Premature sign-offs on audit programs, or the use of audit programs that were either insufficiently detailed or were not accompanied by other workpapers that detailed the work performed.

Similarly, in a report issued in December 2008 summarizing inspections of firms that audited more than 100 public companies during 2004–2007, the PCAOB also criticized these larger audit firms for not applying an appropriate level of professional skepticism (PCAOB Release 2008-008). In a subsequent publication of expanded reports on six inspections of three of the Big Four U.S. auditing firms, this concern was confirmed. The expanded reports covered previously non-public quality control criticisms that were disclosed because the firms had not addressed, to the PCAOB's satisfaction, those criticisms in the 12 months following the date of the inspection report [see SOX section 104(g)(2)]. In the expanded reports, the PCAOB criticized the three firms for either not sufficiently emphasizing the "critical need to exercise due care and professional skepticism when performing audits," or not doing enough through its system of quality control "to assure that accounting and auditing issues are evaluated with the professional skepticism that is contemplated in the auditing standards," or both. (See the reissued inspections reports for Deloitte & Touche LLP, Ernst & Young LLP, and PricewaterhouseCoopers LLP at www.pcaobus.org.)

A common theme in the specific criticisms cited in the reissued inspections reports was an overreliance on management's representations as audit evidence, and a failure to sufficiently challenge those representations.

In August 2013, PCAOB Board Member Jeanette Franzel addressed these concerns at the annual meeting of the American Accounting Association. Franzel acknowledged that the application of pro-

In spite of numerous documents issued on this requirement, auditors continue to be criticized for not exercising sufficient professional skepticism.

Professional Standards Require Skepticism

Professional standards require an auditor of financial statements to maintain an independent mental attitude, to ensure that the audit is performed objectively and without bias. Auditors must also exercise professional skepticism, an attitude that requires a questioning mind and a critical assessment of audit evidence. Those who rely on an auditor's reports expect compliance with these core requirements.

Although the concept had been recognized by auditors in practice for some time, the term "professional skepticism" was first used in 1977 in Statement on Auditing Standards (SAS) 16, *The Independent Auditor's Responsibility for the Detection of Errors or Irregularities*. In 1997, the general standard of due professional care was amended to specifically require auditors to exercise pro-

(PCAOB) published Staff Audit Practice Alert (SAPA) 10, "Maintaining and Applying Professional Skepticism in Audits." Subsequently, in February 2013, the PCAOB issued a public report summarizing its inspections of firms that audited 100 or fewer public companies during 2007–2010. In that report, the PCAOB identified a lack of due professional care—including professional skepticism—as one of several potential root causes of audit deficiencies (PCAOB Release 2013-001). According to the report, in some instances, the lack of appropriate professional skepticism likely occurred because:

- Auditors' confidence or trust in management caused them to accept their assertions rather than sufficiently test them, and

- Time pressure led to heavy partner and professional staff workloads, including for those working in a supervisory capacity.

In addition, the report notes that the following audit deficiencies indicate that

professional skepticism is complex and “crosses multiple disciplines, including auditing literature, theory, and practice; corporate governance; business models; human behavior; and ethics.” She called on the audience to study the influence of pressures and threats to auditor attributes, mindsets, and actions that are involved in appropriately applying professional skepticism throughout the audit process.

Criticisms about the application of professional skepticism are not limited to auditors in the United States. In December 2012, the International Forum of Independent Audit Regulators (IFIAR), which is composed of independent audit regulators from 46 international jurisdictions, issued its first global survey of audit inspection findings. Seventeen of the 22 IFIAR members that provided information regarding their inspections of listed public interest entity audit engagements cited the auditor’s lack of professional skepticism as a possible cause for audit deficiencies in certain inspection findings. IFIAR members were also asked to identify the most significant challenges and audit quality issues in audits of listed public interest entities. Among the most frequently noted challenges was a lack of professional skepticism by auditors (IFIAR 2012 Global Survey of Audit Inspection Findings, <https://www.ifiar.org/IFIAR-Global-Survey-of-Inspection-Findings.aspx>).

In a December 2014 speech at Baruch College’s annual auditing conference, Martin Baumann, the PCAOB’s chief auditor and director of professional standards, referred to SAPA 10 as “required reading,” reiterating the PCAOB’s expectation that auditors must improve their application of professional skepticism. And in August 2014, the PCAOB issued its third report on the progress of the interim inspection program related to audits of brokers and dealers. The report was highly critical of the quality of the audits inspected. Among other things, the PCAOB urged auditors “to be proactive in considering how to prevent similar or other deficiencies and findings by seeking ways to better anticipate and address risks that might arise in specific broker or dealer audits,” and encouraged auditors “to continually stress to their personnel the critical need to conduct audits with due professional care, including professional skepticism” (PCAOB Release 2014-003).

HOW AUDITING STANDARDS DEFINE PROFESSIONAL SKEPTICISM

Auditing standards define professional skepticism in the following different ways:

- An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence (AICPA, AU-C 200.14, Definitions).
- Professional skepticism 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 (PCAOB, AU 230.07).
- The auditor neither assumes that management is dishonest nor assumes unquestioned honesty (AICPA, AU-C 200.A26; PCAOB, AU 230.09).
- Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process (PCAOB, AU 230.08).
- Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of overlooking unusual circumstances; overgeneralizing when drawing conclusions from audit observations; and using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof (AICPA, AU-C 200.A23).
- The auditor’s responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence. Examples of the application of professional skepticism in response to the assessed fraud risks are (a) modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management’s explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources (PCAOB, Auditing Standard 13, para. 7, “The Auditor’s Responses to the Risks of Material Misstatement”).
- In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest (PCAOB, AU 230.09; same concept at AICPA, AU-C 200.A26).
- The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor’s belief about management’s honesty and integrity (PCAOB, AU 316.13; same concept at AICPA, AU-C 240.12).
- Professional judgment includes exercising reasonable care and professional skepticism. Reasonable care includes acting diligently in accordance with applicable professional standards and ethical principles. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of evidence. Professional skepticism includes a mindset in which auditors assume neither that management is dishonest nor of unquestioned honesty (Government Auditing Standards, para. 3.61).

Is It Hard to Be Skeptical?

Why is it so difficult for auditors to apply this fundamental requirement? In SAPA 10, the PCAOB identified a number of possible reasons:

- Incentives and pressures to build or maintain a long-term audit engagement, avoid significant conflicts with management, provide an unqualified audit opinion prior to the issuer's filing deadline, achieve high client satisfaction ratings, keep audit costs low, or cross-sell other services,
- The development, over time, of an inappropriate level of trust or confidence in management,

- Pressure to avoid potential negative interactions with, or consequences to, individuals they know (i.e., management), and
- Scheduling and workload demands.

In addition, people may be predisposed to trust others. An academic study published in 2013 suggests that presumptive trust—a predisposition to believe interviewees—is the prevailing mental perspective of auditors, even when information available to the auditor suggests that there is a risk of deception (C. Lee, R. B. Welker, T. Wang, "An Experimental Investigation of Professional Skepticism in Audit Interviews,"

International Journal of Auditing, vol. 17, 2013, pp. 213–226). This finding is consistent with academic studies on deception detection, which provide abundant evidence that people tend to have a mindset of presumptive trust. Another academic study indicates that expectations are driven primarily by previous client experience; accordingly, because most auditors are not exposed to negative prior experiences, their natural traits prevail (V. Popova, "Exploration of Skepticism, Client-Specific Experience, and Audit Judgments," *Managerial Auditing Journal*, vol. 28, no. 2, 2013, pp. 140–160).

Progress requires further consideration of the possible causes of the lack of professional skepticism identified by audit reg-

PERSONAL TRAITS THAT ENHANCE THE SKEPTICAL MINDSET

Recent academic research identified six characteristics that make up professional skepticism (R. K. Hurr, "Development of a Scale to Measure Professional Skepticism," *Auditing: A Journal of Practice and Theory*, vol. 29, no. 1, 2010, pp. 149–171). These are desirable characteristics that should be inculcated in auditing professionals by educators, the profession and audit firms. The six characteristics are as follows:

- *Questioning mind*: a disposition to inquiry with some sense of doubt. This is an aspect of skepticism that is widely supported from professional standards, accounting research, and research in many other disciplines.
- *Suspension of judgment*: withholding judgment until there is an appropriate level of evidence on which to base a conclusion. Suspension of judgment motivates the next characteristic.
- *Search for knowledge*: a sense of general curiosity or interest, a desire to investigate, to look deep into and beyond the obvious.
- *Interpersonal understanding*: to understand that the motivations and integrity of the individuals who provide audit evidence can affect the quality of that evidence, to recognize the potential for bias that exists in information given by people.
- *Autonomy*: the ability to decide for oneself the level of evidence necessary, to not easily accept the claims of others, and to be able identify contradictions and fallacies present in the evidence and claims of others.
- *Self-esteem*: the confidence to resist attempts at persuasion and to challenge another's assumptions or conclusions, as well as a belief in one's own abilities.

In August 2014, the PCAOB issued its third report on the progress of the interim inspection program related to audits of brokers and dealers. The report was highly critical of the quality of the audits inspected.

ulators, academics, and others, as well as study of the effectiveness of the recommendations already made. For example, Professor Mark Nelson of Cornell University authored a synthesis of numerous research studies and developed a model of the determinants of professional skepticism that may be useful to many stakeholders in the audit process, including researchers, regulators and practitioners (M.W. Nelson, "A Model and Literature

Review of Professional Skepticism in Auditing,” *Auditing: A Journal of Practice and Theory*, vol. 28, no. 2, 2009, pp. 1–34).

How Can Auditors Improve?

Numerous recommendations have been made by academics, the PCAOB (in SAPA

10, inspection reports, and speeches by board members and senior staff), other regulators, standards setters and the auditing profession. This article touches on a few of the more significant of those recommendations and suggests others that are directed to auditing firms, individual

auditors, educators, regulators, and auditing standards setters, as indicated.

Set the tone at the top. Perhaps most important to the appropriate exercise of professional skepticism is the tone set by top management of the audit firm, which is carried down through the leadership ranks and embraced by the engagement partners. The partners and staff need to know that they are expected to be skeptical and that their decisions to seek more evidence in response to their professional skepticism will be supported and rewarded. Communications from top management about audit quality must be substantive and sincere, and not overshadowed by other stated firm goals, such as growth, profitability, and maintaining or enhancing client relationships. Sharing examples of situations in which audit teams discovered important information through their exercise of professional skepticism might enhance these communications.

Inculcate skeptical behavior. Auditing standards and academic research both acknowledge that the personal traits of the auditor are an important part of the auditor’s ability to exercise professional skepticism. An April 2010 academic study by Baylor University Professor Kathy R. Hurr identified six personal traits, or characteristics, that define professional skepticism (see the sidebar, *Personal Traits Enhance the Skeptical Mindset*). These include a questioning mind, suspension of judgment, search for knowledge, interpersonal understanding, autonomy, and self-esteem. Educators, the profession, and firms can all play a role in training and instilling these characteristics and associated behaviors in auditing professionals. For example, a recent academic study provides evidence that a course which emphasizes forensic accounting appropriately influences students’ fraud-related judgments (e.g., it resulted in higher initial risk assessments relative to potential fraud risk factors and increased students’ skepticism) and that the trained students’ improved performance could persist (T.D. Carpenter, C. Durtschi, L. Milici Gaynor, “The Incremental Benefits of a Forensic Accounting Course on Skepticism and Fraud-Related Judgments,” *Issues in Accounting Education*, vol. 26, no. 1, 2011, pp. 1–21).

Be alert. Auditors must remain alert for contradictory audit evidence, infor-

RECENT ADDITION TO THE LITERATURE ON SKEPTICISM

Drawing on previous work with KPMG on professional judgment, as well as the work of other academics and standards setters, professors Steven M. Glover and Douglas F. Prawitt of Brigham Young University discuss the nature of professional skepticism and the difficulties and impediments to its exercise, as well as providing suggestions to enhance its application. This highly accessible work is replete with insights and actionable recommendations.

In their paper, Glover and Prawitt also propose a “professional skepticism continuum,” which suggests that the appropriate application of professional skepticism will depend upon the risk characteristics of the account and the assertion, and advise auditors to vary their level of skepticism during the audit on a continuum based (to a large degree) on the auditor’s risk assessment. The professors’ thoughts and recommendations are welcome in light of the continuing difficulty auditors have in appropriately exercising professional skepticism. Their proposed continuum, however, represents a potentially substantial change from current professional requirements and public expectations, and raises some issues that should be considered further before such an approach is implemented. These include:

- *How the continuum would work together with or complement the existing audit risk assessment and response framework.* Under the proposal, the auditor would increase or decrease his or her skepticism based on the same or similar factors that are used to assess risk and to make decisions about the sufficiency of audit evidence, possibly confusing the auditor’s response to the assessment of risk.
- *How professional skepticism should be exercised when assessing risk.* The auditor obtains and evaluates significant amounts of information (i.e., audit evidence) to assess the risk of misstatement, and continually updates the risk assessment as evidence is obtained and evaluated. The proposal is not clear about how an auditor would exercise skepticism when assessing risk.
- *How the continuum would be applied in practice and whether it could be effectively implemented.* The proposal potentially adds another layer of complexity in understanding and applying the professional standards, and would require auditors to learn how to vary the level of their skepticism.

mation that raises questions about the reliability of evidence and responses to inquiries, and conditions that indicate fraud risk or that otherwise require increased scrutiny. In SAPA 10, the PCAOB states that it is important for auditors to also be alert to unconscious human biases and other circumstances that can cause auditors to gather, evaluate, rationalize, and recall information in a way that is consistent with the client's preferences rather than the interests of external users. Regulators, professional organizations, and audit firms should continue to remind auditors to remain alert to these matters.

Address impediments to skepticism in each audit. As discussed above, the PCAOB and others have cited likely rea-

sense of trust in management? Discussing these matters as a part of the audit engagement planning meeting can enhance the professional skepticism exercised by engagement team members.

Address the problem at the firm level. Auditing firms clearly are aware of regulators' concerns and are taking action at multiple levels to address the problem. For example, in November 2013, the Global Public Policy Committee, which is composed of the largest international auditing firms (BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG, and PricewaterhouseCoopers), published a significant paper on professional skepticism written by Steven M. Glover and Douglas F. Prawitt of Brigham Young University. The paper discusses the nature

description of professional skepticism in the auditing standards is appropriate, because it requires the auditor to maintain an attitude that includes a questioning mind, be alert to conditions that may indicate possible misstatement due to fraud or error, and critically assess audit evidence (see sidebar, "How Auditing Standards Define Professional Skepticism"). When discussing professional skepticism, however, auditors, academics, and others frequently cite the statement that "the auditor neither assumes that management is dishonest nor assumes unquestioned honesty," suggesting that professional skepticism is a more neutral concept, akin to objectivity. That is not the case, and auditing standards setters should amend the description of professional skepticism to provide consistency in the articulation of the standard. Another desirable amendment would be to more forcefully assert the risk that management is dishonest and that mistakes were made in preparing the financial statements.

Study criticisms and auditor behavior further. Audit firms, standards setters, and academics should continue to study the specific criticisms cited by audit oversight bodies and develop means to further inculcate a skeptical mindset and behaviors in auditors. Academics, in particular, could develop and conduct further experimental research with this objective. Such research would be enhanced if auditing firms were to participate.

More Effort Is Required

Exercising professional skepticism is essential to an effective and reliable audit. Recent inspections findings, however, indicate that auditors face challenges in meeting this fundamental audit standard. Although audit firms, academics, and regulatory bodies are focused on this problem, a forceful and sustained effort may be necessary to successfully achieve the desired results. □

Thomas Ray, CPA, is a distinguished lecturer in the Stan Ross Department of Accountancy at Baruch College, City University of New York, New York, N.Y. He is a former PCAOB chief auditor and director of professional standards. He is also a former audit partner of KPMG LLP.

Auditing standards setters should amend the description of professional skepticism to consistently articulate the standard.

sions for lack of professional skepticism. The audit partner on each audit engagement could be required, either as a matter of firm policy or as a part of professional standards, to document how the engagement team overcame each of these impediments on the audit. For example, what steps did the audit partner and other engagement team members take to ensure the team was able to exercise sufficient skepticism in light of tight filing deadlines or strenuous workload demands? Is the engagement partner satisfied that the steps taken were sufficient? Did the engagement team work with client management to ensure that information was provided to the auditor with sufficient time to appropriately evaluate it? How did the engagement team address the possibility that incentives or pressures to maintain the firm's relationship with the client would impair their judgment? What did the team do to resist developing an inappropriate

of professional skepticism and the difficulties and impediments to its exercise, along with actionable recommendations to enhance its application (see the sidebar, "Recent Addition to the Literature on Skepticism"). Audit firms are including this topic in their professional training and other communications, and taking other actions, such as modifying the national office consultation process in ways to promote more skeptical thinking and behavior. Based upon the level of concern expressed by regulators and the inherent challenges in maintaining a skeptical mindset, however, it appears that a robust commitment to solving the problem and sustained efforts are needed to ultimately instill skepticism within each auditing firm's culture and an instinct in each audit professional to think and behave skeptically.

Amend the description of professional skepticism. For the most part, the