



Professional Scepticism: an Academic Perspective

Clean Energy Regulator Annual Scheme Audit and Assurance
Workshop

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Presented by:

Nonna Martinov-Bennie

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Why is audit scepticism important?

- Regulators (e.g. UK FRC, US PCAOB, IFAC, IAASB, ASIC, AUASB) are concerned that professional scepticism is not judiciously applied in audits of financial statements.
 - Based on inspection findings
 - Audit teams did not obtain sufficient appropriate evidence to support their audit opinions
- Scepticism is essential for achieving Audit Quality

Examples of professional scepticism requirements in financial audit contexts



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Item

Standards

- | | |
|---|--|
| <ul style="list-style-type: none">• Definition – an attitude and critical assessment of audit evidence• Responsibilities –<ul style="list-style-type: none">– Maintain professional scepticism throughout the audit<ul style="list-style-type: none">• Planning and performance of an audit; risk assessment; sufficiency of evidence and opinion formation– Recognise possibility of material misstatement<ul style="list-style-type: none">• due to fraud• other circumstances– Investigate inconsistencies | <ul style="list-style-type: none">• ASA 200
• ASA 250; ASA 330
• ASA 200; ASA 300

• ASA 240• ASA 200• ASA 240 |
|---|--|

Scepticism in NGER audit framework context

- **ASAE 3000** “Assurance Engagements Other than Audits or Reviews of Historical Financial Information”
 - Para 28: assurance practitioner will plan and perform an assurance engagement with an attitude of professional scepticism.
 - Para 29: ...makes a critical assessment, with a questioning mind, of the validity of documents obtained and is alert to evidence that contradicts or brings into question the reliability of documents and management responses...

Scepticism in NGER audit framework context

- **ASAE 3410** “Assurance Engagements on Greenhouse Gas Statements”
- **GS 021** “Engagements under the National Greenhouse and Energy Reporting Scheme, Carbon Pricing Mechanism and Related Schemes”
 - Para 8: relevant AUASB standards are applicable (ASAE 3000, ASAE 3410, ASRS 4400, ASAE 3100)
 - Para 44-46: ASAE 3000 provides overarching requirements
- Audit Determination Handbook (2014)



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Our study

- To examine how audit firms *perceive, recognise, develop* and *value* professional scepticism

Method

- Semi-structured interviews of a sample of audit partners in large and medium-sized firms in metropolitan Sydney and Melbourne

What is professional scepticism?

- No universally accepted definition (or measure)
- Research (e.g. Hurtt et al., 2013)
 - A trait: a relatively stable, enduring aspect of an individual
 - A state: a temporary condition aroused by situational variables
- Auditing Standards (ASA 200) definition:
 - “...an attitude that includes questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.”



What is scepticism?

- *“...an abstract concept...”*
- *“...the joker that the regulators can throw out there...”*
- *...one of those buzzwords at the moment...”*
- *“...a bit odd we are trying to set rules and parameters around what scepticism isI mean that is what an audit is about...”*



What is scepticism? – cont'd

- *“...not taking [what client tells you] on face value... understand not only mechanics of transaction but really what is the substance...”*
- *“...part of decision process...part of your [audit] tools...”*
- *“...scepticism is about challenging, about corroborating...”*
- *“...just a mindset ... having that questioning type of mind, don't accept things on face value...critically assess what's being represented...”*



Scepticism and Judgment

- *“...a definite relationship...applying scepticism...you have to exercise judgment as to what you’ll accept and what you won’t accept.”*
- *“...scepticism is an input into process. The process is the judgment, the way you make that judgement and draw your conclusion is driven by the mindset you bring to that process.”*



Scepticism and Audit Quality

- *“...fundamentally important to getting [audit] quality...”*
- *“...see scepticism as feeding into the performance of audit which is one of the drivers of audit quality”*
- *“...scepticism, or your mindset, is a critical part of [auditing]; it's not the same as judgement but you need to be sceptical to form a good judgement...”*



Scepticism and Independence

- *“...hard to separate the two...”*
- *“If you are not independent, it can cloud your ability to be sceptical.”*
- *“...need to have an independent mind in order to display professional scepticism...they are kind of married to each other.”*



Scepticism and Audit Risk

- *“...there is a base level [of scepticism] that you would apply no matter what...heightened by client context such as risk and complexity...”*
- *“...high risks, need to be definitely more sceptical”*

Fixed trait or acquired ability?

A common perception is that professional scepticism is

EITHER

A fixed trait that some have and others don't

OR

It's a skill developed through training

This “either/or” approach limits the options:

- If it’s a fixed trait:
 - Training becomes irrelevant
 - All you can do is screen for “talent” and
 - Impose strict methodological controls

This “either/or” approach limits the options:

- If we think of scepticism as an ability that anyone can be trained for:
 - screening becomes relatively irrelevant (when some screening seems warranted)
 - there is no strategy for accommodating those who have difficulty learning to be sceptical

A more nuanced approach based on our research:

Scepticism is

BOTH

- an acquired or learnt ability

AND

- depends on the learner's aptitude

Support from interviews with auditors:

- *“I think part of it is you've either got it or you don't. But then a lot of it is on the job and getting better at your job and being exposed to those discussions in the audit room”*
- *“You kind of need to have a certain ability to begin with...but to enhance it...and develop it”*
- *“I think that you can train it into people...but they'd have to have an open mind and enquiring...”*
- *“Is scepticism a skill, can you train it, is it experience, do you have to learn it on the job or is it just innate when you're born...It's probably a mixture of all three.”*

In the “Aristotelian” view (i.e. scepticism as a virtue):

Scepticism is a practical skill that is

- acquired on-the-job
- by trainees participating in the activity (e.g. auditing)
- under the guidance of those who already have the skill

What our interviewed auditors said:

- *“It's something that you're doing as you're listening to what they're telling you... learning it by getting queried and [them] saying no go back, go back, go back.”*
- *“That's where you really learn, outside, because you really get to apply whatever it is you've learnt and you can see where the differences are...So on-job is critical.”*
- *“It's not something you'd get out of a textbook.”*
- *“I think the classroom training only takes you so far... Until you're actually out there...it's really the on the job training.”*
- *“It's when you actually have to practically apply it that it starts to become real.”*

But there is another side of the “Aristotelian” view:

- Successful training depends on an aptitude for learning

which is

- itself acquired through early “training” – through culture, schooling, a broad education...

According to the auditors we interviewed:

- *“You can clearly see very early in the piece the people that are going to be comfortable and progress quicker based on the way they interact...”*
- *“It's a huge benefit for someone to come into auditing that has done other courses...the more analytical ones...For me it comes back to having an inquisitive mind...”*
- *“You don't need a highly intelligent person, you need someone that is analytical, inquiring...”*
- *“There are people that haven't been suited to auditing - they came in with no common sense”*
- *“Some people have been raised so that they don't question and they come from cultures as well that don't question...”*

On our “Aristotelian” model, professional scepticism is supported by a broader “community of practice”

The practice of professional scepticism is embodied in a **workplace culture** that includes

1. Experienced personnel and training methods
2. Quality controls, auditing standards and codes of conduct
3. Audit methodology
4. Governance structures
5. Regulation by the profession, regulators and standard setters



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Comments, questions?