Research Related to Auditor Professional Skepticism

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What do we know:

Commissioned Research / Syntheses

Author(s)	Commissioned By
Nelson (2009)	
Auditing Practices Board (2010)	APB
Hurtt et al. (2013)	PCAOB
Glover and Prawitt (2014)	CAQ & GPPC
Brazel and Schaefer (2015)	IAASB
Ramamoorti & Gramling (2017)	IAESB

Big Picture Observations

➡ Majority of research is based upon Nelson (2009)

Incentives	Traits

Knowledge

➡ PLUS…

Environmental Factors

➡ Skeptical Judgment

Skeptical Action
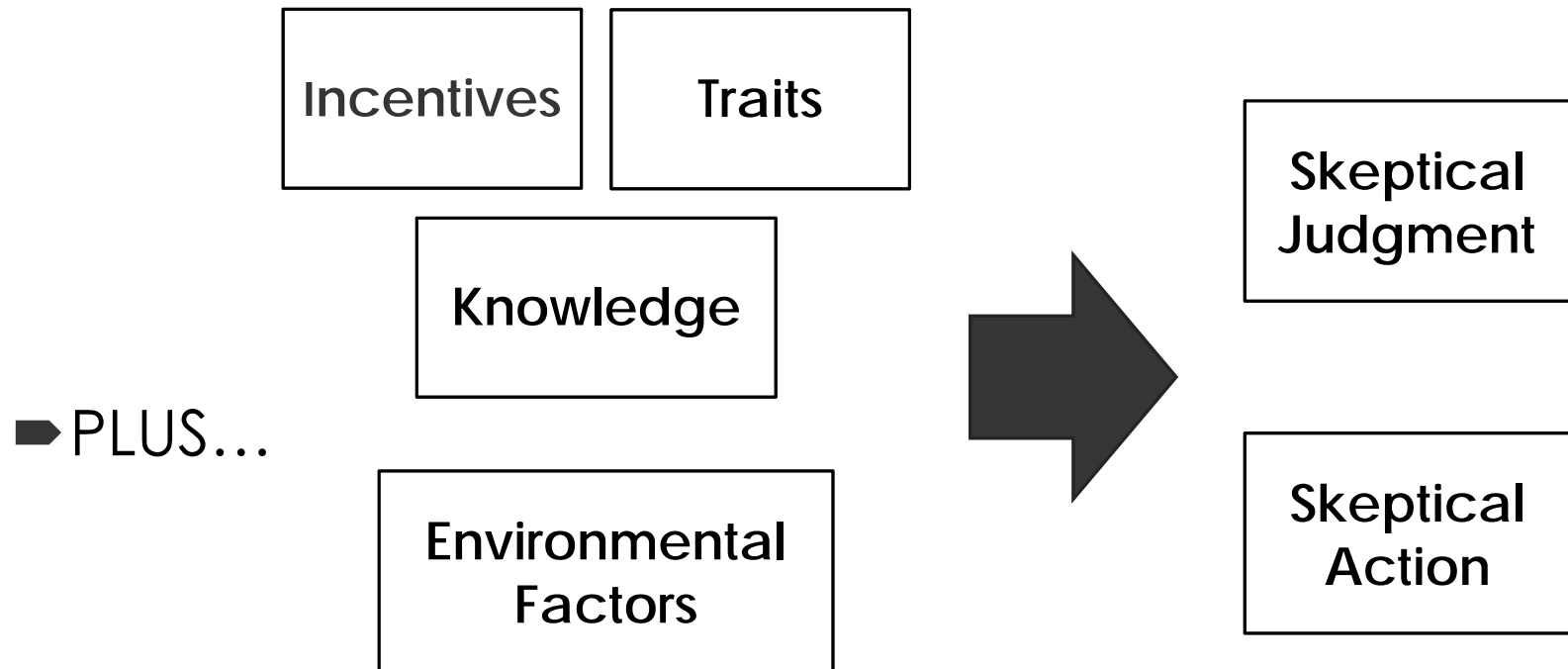
➡ Many unpublished papers – this is an important, timely issue researchers are attempting to tackle

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Big Picture Observations

➡ Majority of studies **define** PS as: a questioning mind … critical assessment of audit evidence

➡ PS manifests itself in audit judgments & decisions

  ➡ **Measurement** of PS varies based on the study's context:

   ➡ Assessing an account as more risky

   ➡ Collecting more evidence / spending more time / searching for inconsistent evidence(changing NTE of testing, less SALY)

   ➡ Challenging an aggressive accounting treatment

   ➡ Estimates of accounts that differ from client estimates

Big Picture Observations

➡ Lots of research starting to examine PS as a trait or auditor characteristic

  ➡ Nature and nurture

  ➡ Role of screening and monitoring

➡ Minimal research on basic incentives for PS

➡ Research often aims to enhance audit practice, not necessarily enhance audit regulation

Knowledge

- ➨ The focus of most competency-related studies is on the extent auditors can detect and respond to fraud red flags/risks

- ➨ Auditors do not generally respond appropriately to personality-driven fraud tendencies in management

Traits

- ➨ Auditor characteristics predict auditors' PS judgments

- ➨ Auditors with greater PS stand more resolute when issues arise with management

Environmental & Contextual Factors

➥ The characteristics and actions of management may impact PS, but in high risk settings auditors appear to generally exercise more PS

➥ The framing/word choice of tasks alters the mindset or approach auditors take, leading to more/less PS

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Time

➡ Time pressure & workload impact (Lambert et al. 2017)

  ➡ Audit partners surveyed regarding SEC 10-K filing accelerations in the 2000s → created more time pressure & less PS

  "We had to cram 45 days of skepticism into 30 days and I found that we were not **asking good follow up questions** because we had 50% more questions outstanding at any point in time."

  "Our teams had less time to **sit-back and think** about alternative scenarios for complex client transactions."

Time

➡ 800 auditors surveyed…workload is high enough that audit quality suffers (Persellin et al. 2017)

➡ During busy season: 5 – 20 hours above threshold: 40% indicate impaired judgment, reduced PS

"…There became more of a 'how can I document that this works' instead of a **'does this work' approach.**"

"When there is a time constraint…you also feel some pressure to trust your own gut on certain issues. For example if a journal entry doesn't appear in line with expectations and it's late at night, you may try to just explain it yourself, rather than **spending the time to discuss with the client to get a full understanding.**"

Time – Interview with a former CFO convicted of fraud

➡ "As far as the auditors were concerned...for things that are hard for them to get their arms around, trying to get them to the **"materially comfortable" place through confusion**…and…just keeping them busy on non-audit related activities, it kind of pulls them away from the basic audit itself."

➡ "The **analysts were much more difficult than the auditors** because the analysts were looking more at market/industry comparisons, whereas the auditors were focused on transactions. We could explain away the transactions, but the analyst questions about why we differed from peers were more difficult…[auditors may be more effective] if they focused more on some of those **global types of questions**…"

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Incentives

- Sources of pressure that increase/decrease PS (Westermann et al. 2015)

    - Increase: sources that hold auditors accountable for quality (inspections / workpaper reviews)

    - Decrease: sources that promote defensibility or profitability (time budget pressure / excessive documentation)

- Inspection pressure "good" for PS, unless excessive documentation is over-riding concern

- Evaluators rate staff based on the **outcome of skeptical behavior** vs. whether the skeptical behavior was appropriate (Brazel et al. 2016)

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Linking Barriers to Solutions

Barrier to PS →   Audit Evaluators reward appropriate PS based
on outcomes (identified a misstatement or not)

Auditors testing in the field are aware of this bias

Auditors in the field are less likely to identify and
convey **FRAUD** red flags /evidence inconsistencies

Solution 1: AC SUPPORT may not "help"

Solution 2: CONSULTATION helps but does not eliminate the bias

Solution 3: EVIDENCING skepticism in the budget file may not
"help"

**Solution 4: REWARD skepticism – this can backfire or help…it
depends…**

Linking Barriers to Solutions

Conclusion: Hindsight bias is robust and extremely difficult to overcome!

➡ **Good News (latest research)!**

- ➡ Supervisors experiencing a culture emphasizing consultation & tone at the top that appropriate PS is valued = LESS BIAS!

- ➡ LESS BIAS, consistently REWARD PS → More PS amongst staff!

➡ **How can we increase skepticism…** create a culture where appropriate skepticism is consistently rewarded, regardless of outcome.

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