

Spring 5-2-2014

# Breaking the Barrier – An Examination into the Current State of Professional Skepticism

Rebecca K. Curtis

*University of Connecticut - Storrs*, [beccurtis@sbcglobal.net](mailto:beccurtis@sbcglobal.net)

Follow this and additional works at: [http://digitalcommons.uconn.edu/srhonors\\_theses](http://digitalcommons.uconn.edu/srhonors_theses)

---

## Recommended Citation

Curtis, Rebecca K., "Breaking the Barrier – An Examination into the Current State of Professional Skepticism" (2014). *Honors Scholar Theses*. 340.

[http://digitalcommons.uconn.edu/srhonors\\_theses/340](http://digitalcommons.uconn.edu/srhonors_theses/340)

**Breaking the Barrier – An Examination into the Current State of  
Professional Skepticism**

Rebecca K. Curtis

University of Connecticut

May 2<sup>nd</sup> 2014

## **Abstract**

Since the implementation of Sarbanes Oxley and the establishment of the PCAOB in 2002, more procedures have been set in place to ensure auditors and accounting firms are adhering to rules and regulations to avoid scandals or misuses of reporting that occurred during the Enron, World Com and Arthur Andersen era. Although these regulations were set in place to ensure auditors perform with utmost care and responsibility, there is still uncertainty in regards to the level of professional skepticism auditors'-use when gathering evidence and evaluating client financial statements. This paper will begin by giving a general overview of professional skepticism and how it is defined in current accounting regulations. I will also discuss what critics may call the root causes that lead to a lack of professional skepticism. I will then analyze the responses from a questionnaire distributed to professionals and suggest further areas of research.

## Introduction

The Accounting industry changed dramatically after large accounting scandals during the early 2000's. In early 2001, it began with Enron filing bankruptcy with approximately \$62 billion in assets and shortly after, WorldCom filed for bankruptcy with \$100 billion in assets (Nichols, 2006). Furthermore, public Accounting firms did not sufficiently question this fraudulent reporting which eventually led to the establishment of the Sarbanes Oxley Act in 2002 and more oversight of audits by the PCAOB. New regulations, policies and procedures have been implemented to increase auditor professional skepticism. An example of this can be seen by reviewing fraud cases that have been filed with the SEC. In a *Journal of Accountancy's* article, "Top 10 Audit Deficiencies: Lessons from fraud-related SEC cases," an analysis conducted in 2000 identified ten problem areas that were found in SEC Enforcement Actions from 1987 to 1997. The third biggest audit deficiency was "demonstrating appropriate level of professional skepticism." Approximately sixty percent of the SEC Enforcement Actions analyzed were due to a lack of applying an appropriate amount of skepticism (Beasley, 2001).

The lack of professional skepticism seems to be a common finding in the world of Accounting. For example, the PCAOB found fault with approximately 48% of Ernst & Young's audits (Kim, 2013). Additionally, as business transactions become more complex and accounting standards are continuously updated and revised, auditors need to be focused on applying professional skepticism to their fieldwork (Glover, 2013). Although previous incidents of frauds and misstatements make it evident that professional skepticism needs to be applied through all aspects of the audit, it is not clear what has caused this lack of professional skepticism. Is the level of professional skepticism a result of an auditor's professional experience and background, or is it a quality that can be trained or taught? It is also clear that

additional research and analysis needs to be carried out to determine the root causes of insufficient skepticism. Establishing a more specific view on professional skepticism can benefit professional auditors and also organizations that create standards and the functioning of capital markets (Carpenter, 2012).

The importance of professional skepticism may be more emphasized in the industry today, but the debate remains on which individual on the designated engagement team illustrates the appropriate skepticism applied during the audit. Research has shown that professional skepticism was higher among auditors who had recently graduated college than among more experienced audit managers (Rittenberg, 2012). Furthermore, too much professional skepticism may not be beneficial in the industry. Increased levels of professional skepticism can help detect more material misstatements and avoid the potential occurrence of fraud, but this may come with potential consequences. An auditor's increased level of professional skepticism can eventually lead to costly audits, as more work is being performed in order to attain sufficient support and evidence of management's assertions (Nelson, 2009). The audit planning and constructing process may become overly inefficient and expensive (Nelson, 2009).

Moreover, individuals may enter the auditing profession with a natural inclination towards curiosity and a questioning mindset, but one may argue professional skepticism is developed in both direct and indirect actions. For instance, people may argue that professional skepticism is not innate, but more so developed over time, whether directly through professional experience and company training or indirectly through a firm's corporate structure and culture (APB, 2010). Is professional skepticism a trait that can be fostered through increased budgeting efforts and expenditures or is it a quality that can be trained and enhanced by the accounting firm's culture? Additionally, professionals have debated whether real-life experiences or firm-

provided training best enrich an auditor's quality of professional skepticism on an engagement. In 2012, a study was conducted to compare and contrast the factors that affect students' and professionals' decisions to pursue careers with Big Four versus Non-Big Four accounting firms. The experiment involved 34 MSA students and the belief elicitation results showed perceived Big Four advantages and disadvantages. One noticeable disadvantage was "less exposure to the full audit" which was recognized by approximately 21 percent of the participants (Bagley, 2012). This may indicate that Big Four accounting firms have more effective training programs and that local to mid-sized firms receive a closer interaction with all levels of the engagement team from partner to associate. Similarly, in the same study, of the 263 practicing professionals that participated in the belief elicitation, 25% of professionals felt that a Big Four advantage was the availability of better training and resources (Bagley, 2012). The observation from my research shows that perhaps there is a difference based on firm size that determines what way an auditor will enrich his or her professional skepticism qualities.

In this thesis, I will first present a general discussion of professional skepticism. I will then present the results of a questionnaire that was distributed to professionals. The questionnaire was composed based on background professional skepticism research. The interviewees consisted of professionals that were previously and currently in the public Accounting industry. The purpose of the questionnaire was to obtain general perceptions of professional skepticism from different professionals that have been in the industry at some point in their career. The questionnaire will focus on topics including the perceived current state of professional skepticism and whether professionals believe the industry needs to stress more concern and importance over the auditing behavior. The analysis of the questionnaire will compare and contrast the various point of views of manager and partner level individuals, as well

as people such as a professor who was in public Accounting and now teaches Accounting at the University level. This analysis compares the different viewpoints across different professional backgrounds. This questionnaire will be given to representatives who either formerly or currently have represented an Accounting firm ranging from the Big Four, regional, or local smaller-sized firm.

### **General Understanding of Professional Skepticism**

Professional skepticism is an integral aspect of the audit profession. In general terms, professional skepticism is due care that an auditor should strive to emulate in their work. As described by the International Standards on Auditing (ISAs), professional skepticism is a questioning mind attitude and a critical assessment of audit evidence to be aware of possible misstatements that may arise from fraud and/or human error (IAASB, 2013). This questioning mindset should be practiced by all people involved in the “financial reporting supply chain” (CAQ, 2010). Along with an auditor’s mindset, other elements of professional skepticism include an auditor’s attributes and actions (Franzel, 2013). The word skepticism is derived from a Greek verb that means to inquire. Additionally, the word skeptic is derived from *skepsis*, A Greek noun that relates to “examination, inquiry, and consideration (IEP). Skepticism does not mean a complete lack of trust, but an act of confirming information received by others such as management clientele. The Center for Audit Quality describes this as the “trust, but verify approach” to auditing (CAQ, 2010). Professionals demonstrate the act of skepticism by paying attention to inconsistencies, validating information and performing a critical assessment of financial evidence (CAQ, 2010). If auditors fail to utilize any level of skepticism, auditors’ may not obtain the appropriate evidence needed to support their financial opinion.

Professional skepticism is not only important with the context of fraud, but also crucial for the more complex, highly judgmental components of the audit. Examples of this include: accounting estimates, fair value estimates, evaluating decisions and assumptions used by an entity's management, etc. (IAASB). These parts of the audit may illustrate "great measurement uncertainty" to the auditors (Tysiac, 2012). This questioning approach is not only encouraged while conducting the financial statement audit, but in the preliminary planning work as well. A member of the PCAOB, Jeanette Franzel, says that professional skepticism is comprised of three elements: auditor mindset, auditor attributes and auditor actions (Kim, 2013). The emphasis on applying increased levels of professional skepticism in the audit field is not meant to create an aggressive environment for professionals (CAQ, 2010).

### **Professional Skepticism in Accounting Publications**

It is also important to view interpretations of professional skepticism from multiple Accounting publications. Professional skepticism's importance in the audit practice is illustrated in various United States Auditing Standards (Hurt, 2008). Although professional skepticism is discussed heavily throughout accounting standards and regulations, one may argue it is discussed with little scrupulousness (Nelson, 2009). Professional skepticism is continuously mentioned in Statements on Auditing Standards. For example, the concept of professional skepticism is introduced in the PCAOB's publication of SAS No. 82, *The Role of the Auditor in the Prevention and Detection of Business Fraud*. In November 2002, the Auditing Standards Board (ASB) issued SAS No. 99 – Consideration of Fraud in a Financial Statement Audit. These Auditing Standards were issued after fraud scandals including WorldCom (Arthur Anderson), Xerox (KPMG) and Enron (Arthur Anderson) (Bukics, 2003). The ASB issued SAS No. 99 to



supersede SAS No. 82. SAS No. 82 focused on the detection of fraud, while SAS No. 99 focuses on the prevention and deterrence of fraud (Marczewski, 2005). SAS No. 99 is relevant to this discussion because it states that professional skepticism should be practiced during all stages of the audit, from planning the audit to conducting the audit. An auditor should illustrate professional skepticism at all times regardless of prior experience with the client (Bukics, 2003). Auditors should maintain a questioning mind and critically assess the evidence from client management to see if fraudulent misstatements exist (Brickner, 2003).

International Standard on Auditing 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, effective December 15, 2009, illustrates auditors' responsibilities dealing with fraud during the financial statement audit. The professional skepticism requirements in this ISA help the auditor to assess risks of material misstatement due to fraud and help in the design of procedures used to detect these misstatements (ISA 240, 2009). Furthermore this auditing standard stresses the notion that procedures and courses of action that are effective in detecting financial statement errors may not be simultaneously effective in detecting a more material misstatement or fraud (ISA 240, 2009). Statements like these may indicate that firms need to incorporate more investment and resources into auditor training to "train" the different approaches to skeptical areas of the audit engagement. However, professionals or other critics have argued the idea that a questioning mindset and attitude is not a mindset that can be trained, but rather established over time through various levels of experience.

Moreover, the PCAOB's oversight activities continue to express concern that current auditors are not diligently applying a critical level of professional skepticism (Franzel, 2014). For instance, the continuous misapplied professional skepticism led to a Staff Audit Practice Alert issued by the PCAOB during 2012 – *Maintaining and Applying Professional Skepticism*.

This practice alert notes that the PCAOB defines professional skepticism as having a “questioning mind and critical assessment of audit evidence” (PCAOB, 2012). Along with a brief summary of professional skepticism guidelines, the PCAOB believes in the idea that professional skepticism can be used more during the audit process with the improvement of firm’s quality control systems (PCAOB, 2012). Establishing a proper quality control system will help bring forth an atmosphere in which auditors can perform with due professional care and not make business decisions based on pressures from the firm (Beasley, 2001). Issues pertaining to quality control systems will be discussed in the following section, as these represent possible limitations to applying professional skepticism.

### **Potential Barriers to Professional Skepticism**

Although professional skepticism is encouraged by accounting policy-makers, there lie potential barriers that limit the auditor’s effectiveness of practicing professional skepticism. According to the International Auditing and Assurances Standards Board (IAASB), professional skepticism is influenced by an auditor’s behavioral traits such as attitudes or ethical values and by one’s knowledge when taking on the engagement (IFAC, 2012). In addition, however, professional skepticism can also be influenced by other factors that include but are not limited to:

#### ***Tone set from firm leadership***

The importance of professional skepticism can be affected from the firm’s leaders (Staff Audit Practice Alert No. 10, 2012). In the Staff Audit Practice Alert No. 10 the PCAOB defines this as “Tone-at-the-Top Messaging.” The business world can get caught up in the revenue, profit and growth of a company and overlook the quality of the firm audits and more importantly, lose professional skepticism practices. Academic research suggests that proper tone at the top leadership is a result of a leader’s emphasis on effectiveness rather than efficiency

(Carpenter, 2013). This suggests that an auditor can increase their level of professional skepticism by focusing on how useful the financial statement audit is versus how well, or efficient, the audit is conducted. The firm's culture needs to promote the idea that verifying and asking questions is "healthy and appropriate" when performing external audit procedures (CAQ, 2010). It is possible that a firm's leadership and culture that promotes professional skepticism, will lead to more thorough audit practices.

Along with accountants being concerned with meeting the firm's revenue and growth, accountants may not approach an audit with skepticism due to a firm's promotion policy or their goal to seek appraisals. A firm's promotion guidelines may distract an auditor from practicing professional skepticism to solely focus on the tasks to receive an appraisal or promotion. The PCAOB provides a great example that can be a potential barrier to applying skepticism. If the firm emphasizes the engagement team to reduce audit costs or focus on maintaining a client for another year, auditors may be more focused on achieving this than ensuring the audit is performed with quality and professional skepticism to avoid misstatements.

### ***Lack of knowledge or training***

The PCAOB also considers lack of technical training, knowledge and experience could be barriers to exuding appropriate levels of professional skepticism. As the PCAOB says in the Staff Audit Practice Alert No. 10, "Professional skepticism is interrelated with an auditor's training and experience, as auditors need an appropriate level of competence in order to appropriately apply professional skepticism throughout the audit." The interviews that I will be conducting are going to touch across the different point of views to this particular topic. Former and current Accountants may hold different views on whether the quality of professional skepticism comes from experience or is something that can be trained initially.

### ***Predisposition to clients***

Auditors may establish a high level of trust with either the client or the audit committee after working on an engagement for several terms. According to the Global Accounting Alliance (GAA), the more the auditor trusts the client, the less skepticism an auditor may use in his or her approach (GAA Accounting, 2012). An auditor's predisposition to clients can result in missing material misstatements or lack of proper risk assessment, overlooking the big "red flags" (GAA Accounting, 2012). Additionally, the auditor may be presented with situations that are high risk, but fail to make modifications to the audit procedures during the audit process (Beasley, 2013). For example, documentation can be another issue auditors may face that affects his or her level of skepticism. An auditor may question the authenticity of client-produced documents, but never assess the possible client manipulation (Beasley, 2013). Firms should encourage professionals to ask more questions that can help mitigate potential financial and fraud risks in the near future (CAQ, 2010).

### **Questionnaire Analysis**

The questionnaire was distributed to multiple professionals with different levels of experience/professional training. Please see the distributed questionnaire in Appendix A. Individuals participating in the questionnaire include partners with roughly 40 plus years of professional experience, newly started partners, to senior managers. The questionnaire was also distributed to individuals who have been somewhat removed from the profession, but have become Accounting faculty members of a University. The five professionals who participated in this questionnaire exhibit professional experience ranging from approximately five to thirty-eight years in public Accounting. Three of the five participants have professional experience from a

Big 4 Accounting firm. The remaining two participants have professional experience from a regional and local firm respectively.

It is important to note that professional skepticism is a rather subjective topic and of difficult nature to measure. However, from the professionals' general perceptions we can concur the following:

### ***The Current State of Professional Skepticism***

Overall, it is evident there is a general consensus that the current state of professional skepticism is that there is more emphasis over professional skepticism than the past 5 and 10 years ago. Furthermore, it is noted that 10 years ago, around 2002 – 2003, there was a major focus on professional skepticism in light of Enron and other incidents of fraud. The Enron, World Com and Arthur Andersen era substantially raised the emphasis of professional skepticism in the audit practice. A Big Four partner of 38 years notes that there are more areas of judgment involved and there was a more noticeable focus on professional skepticism exercised immediately after the “Enron and Arthur Andersen era” in the early 2000's. There is a general consensus that in the past ten years, there has been more pressure and emphasis to not only detect incidents of fraud or misrepresentation, but also carefully plan the financial audit to help detect fraud.

### ***Newly Hired Auditors' Professional Skepticism***

Consistent with the belief that there is more of an emphasis on professional skepticism today than prior years, the professionals generally agree that newly hired auditors today enter the industry with more professional skepticism characteristics than newly hired auditors in the past. A professional partner even stated that he is certain he was less skeptical when he started his career in the industry 33 years ago. Interestingly, although the question was simply asked, 3 out

of the 5 participants, when explaining their reasoning, placed a large emphasis on a student's educational experience that supports this increasing amount of professional skepticism. It is evident that professionals believe that accounting scandals and fraudulent reporting not only affect Accountancy at the CPA/firm level, but Accounting curriculum at colleges and universities. Focusing students' studies around Enron and Arthur Anderson brings awareness to the consequences of not being skeptical and helps students' "fine-tune" what is expected of them as auditors in the industry. A partner from a local firm also pointed out that newly hired auditors being more acclimated with professional skepticism, not only benefits the detection of fraudulent reporting, but can help auditors to simply detect minor errors in the audit practice. However, as one participant noted, despite the educational background or knowledge, everyone is a unique individual. Furthermore, professional skepticism traits vary from person to person. Newly hired auditors may possess a larger amount of skepticism versus a newly hired auditor who may be somewhat naïve and adapt with more professional experience and/or training.

### ***Important Quality Developing Professional Skepticism***

Although new professionals may enter the workforce with varying levels of skepticism in general, the participants did not feel that skepticism as an inherent trait was not important to the development of an auditor's professional skepticism. Instead, professionals argued that training and experience are the most important qualities in the development of professional skepticism. Training and experience, combined, both complement an auditor's professional skepticism development. Overall, three out of the five professionals interviewed believe that experience is the most important quality in the development of an auditor's professional skepticism. Professionals illustrate that on-the-job training and real-life work situations can enable an auditor to develop the proper listening skills and ability to pay attention to every detail in the planning

and audit performance. A professional describes the most important quality as a “learn by doing” approach that is encouraged by all levels of the firm. In addition, a former Big Four partner mentioned that it is oftentimes difficult to approach the development of professional skepticism through a more formal manner such as firm training.

An interesting observation of the questionnaire results was that two of the five participants answered that training was the more important quality in developing professional skepticism. Training can be argued to be the key to establishing the next important quality, real developmental experience. These two professionals interviewed are or were once partners in the industry for over thirty-three years. Considering professionals who have been in the industry for thirty years or more this could possibly indicate that the training concerning professional skepticism has been modified over the years. There may have been more emphasis and focus on the quality of professional skepticism training compared to current firms’ training programs. Additionally, a manager and partner with half as many years of professional practice under their belts believe experience is the most important quality in enhancing professional skepticism because they are more involved in the audit review process during the engagement. Audit associates, seniors and managers tend to participate more in the reviewing of audit work and therefore may feel that real-life, on-the-job experience is more helpful in developing one’s level of professional skepticism. This could also contribute to the idea that training on professional skepticism is currently not as prevalent in the field and that professional skepticism is best perfected with hands on experience with the audit engagement. However, generally, continuous years of training and experience/application can lead to the establishment of inquisitive auditors focusing on all significant details of the planning and audit process. This analysis also concludes that professionals previously involved or currently in the industry may presumably agree that

professional skepticism is an important quality that is currently maintained and further fostered through the firms' cultures, and tone set from upper level employees.

### ***Illustrating Professional Skepticism in the Firm***

There were varying responses in regards to who is more likely to illustrate professional skepticism in the firm setting. Three of the five professionals interviewed believe that the partner is more likely to illustrate professional skepticism in the firm setting. An even more interesting observation was the fact that several participating professionals felt that their, either current or past professional title, was the level that exhibits the most professional skepticism in the audit process. A manager felt that a manager/senior was more likely to display the most professional skepticism among the firm. Also, various individuals who have had some sort of partner experience believe professional skepticism largely starts with the audit partners. It is evident that professionals directly correlate professional skepticism with experience.

The more experience an auditor has, the more likely these auditors convey the appropriate questioning mindset and attitude to the other levels of the engagement team. This analysis relates back to the idea of the "tone-at-the-top" messaging. If the proper tone is set at the highest level in the firm, it will be conveyed to the Manager level and in return the managers can convey these mannerisms to the associates. As the former senior partner has mentioned, the partners are crucial individuals who set the tone so staff can attain a better understanding of the important components of the financial audit.

When asked the question of who is likely to illustrate more professional skepticism, the 5 professionals' answers ranged from the associate/senior level all the way up to the partner level. Therefore, one can confer that the accounting standards have been effective overall in promoting more professional skepticism among all levels of auditors during the engagement. As



previously mentioned, SAS 99 established by the PCAOB encourages professional skepticism at all levels of the audit, from the planning process to the actual audit work and questioning of management information. Therefore, we may conclude that professional skepticism since the early 2000's has largely affected all levels of the engagement team from associate to partner level. Higher-level employees have set the tone for the auditors to follow accordingly. Although more years of experience and training can enhance professional skepticism, it is apparent that professional skepticism is being applied by a majority of audit engagements from the actual audit work being performed to the reviewing of the audit materials.

The analysis of this question can also be viewed from a firm-level perspective. The professionals who represent a Big Four, larger firm expressed that partners illustrate the most professional skepticism to all levels of auditors. In contrast, the professional representing a more local smaller-sized firm, expressed that associates, or lower-level employees with more experience under their belt are more likely to exemplify traits of professional skepticism. This observation may lead one to presume that there lays a difference in the curriculum or amount of training provided to auditors in a small localized firm versus a large, national firm. This may correlate with varying levels of training a Big Four accounting firm versus a smaller mid-sized firm provide to their staff. An associate at a Big Four firm may enhance their professional skepticism behavior through more training. Meanwhile, an associate at a local firm may perfect their professional skepticism behavior more through their personal experiences. Mid-tier to smaller sized firms have team structures that enable more closer interaction among all higher level and associate level auditors of the engagement team that may compensate for less rigorous “national firm esque” training (ACCA & ARCA, 2012).

***Do the Firms Concern Enough Over Professional Skepticism?***

One professional noted that since big fraud scandals from the late '90's and early 2000's, partners have increasingly become more involved with all levels of auditors. From his personal experience, partners are actively a part of meetings with staff associates and no longer only focused on signing the final report. Partners are described as the most experienced individuals of the audit engagement. Furthermore, one professional noted the different concerns of different levels of auditors. The lower, less experienced levels of the audit engagement team are more focused, or concerned, with producing great quality audit work for the manager and partner levels of the engagement. At the staff/associate level, one may presume that there is less time to take a step back to question client material and these auditors are primarily focused on the audit procedure versus audit details. In contrast, the partner of the audit is less concerned with how a client's cash was audited, but will review the audit work with a skeptical mindset, looking for unusual trends or differences over periods of time. One may argue that this skeptical mindset and nature comes with more experience and "training-by-doing" in the industry.

This perspective can essentially correlate with the belief that there needs to be more concern over professional skepticism from the firms. When asked this question, all participants except for one felt that the firms need to express more concern over performing audit work with the utmost due care and professional skeptical behavior. The manager of a Big Four firm felt that the firms had greatly increased the training and development set aside for professional skepticism and that no more concern was necessary. Meanwhile, current and former partner-level professionals feel that the focus on the development of professional skepticism has declined since the early 2000 Enron era. A current partner commented that his firm continues to make professional skepticism a top concern for all members of the audit team. Perhaps the managers lack of more concern is correlated to the tasks associated with his role. As previously

mentioned, the associates, seniors and possibly managers focus on the quality of their work whereas the senior managers and partners view the overall “big picture” of the audit/engagement.

### ***Future Actions to Help Increase Awareness of Professional Skepticism***

The current state of professional skepticism may be at the highest peak since ten years ago, but professionals suggest that policies can be set in place at the firm level to help bring more awareness of the importance of professional skepticism to auditors. The overall consensus is that firms need to continue or increase the amount of training provided to all different level auditors on the engagement team. A former partner and Instructor in Residence at the University of Connecticut emphasized that there needs to be more training on not only the techniques associated with practicing professional skepticism, but the overall importance of applying professional skepticism in the audit practice. The manager and three partners emphasized training as a firm level action. The manager stated that on-the-job training and real-life case studies/scenarios really help demonstrate the appropriate levels of professional skepticism staff needs to replicate on their audits. A local partner also noted that it is important that the proper tone is enforced from different levels of the firm. For example, he comments that a senior needs to emphasize the importance of professional skepticism to staff while concurrently, the staff needs to be given firm training that focuses on *developing* this crucial skillset. We can further conclude that professionals formerly or currently in the industry strongly support the idea of development training to develop professional skepticism. This form of training may be more crucial to auditors than just the technical training on FASB and IFRS guidelines.

### ***Is Professional Skepticism Consistently Applied Appropriately?***

With regards to the participating professionals’ experience and background, the general consensus was that most fraud cases that they are aware of, were approached with a significant

amount of professional skepticism. Although professional skepticism was applied professionals concur this does not mean that the fraudulent reporting or actions was not handled in the best manner. A manager mentions how those clients that will commit fraud are most likely going to be cautious and work around the auditors' professional skepticism to achieve their manipulative "cooking of the books" and fraudulent objectives. A former Big Four partner with 38 years of professional experience discussed a fraudulent case concerning a large discount drugstore chain in the United States, Phar-Mor, Inc. and the audit firm Coopers & Lybrand LLP from 1992 (Bazerman, 1997). In this particular case, Phar-Mor was found guilty of collusive fraud performed by several members of their top management, but the auditors were being sued as well for "reckless auditing" (Cottrell, 1997). The auditors were not illustrating enough professional skepticism and did not realize the big red flag of inventory inflation and other fraudulent reporting that led to approximately a \$985 million earnings overstatement in a three year time span.

In this case, professional skepticism was not nearly applied to the level it should have. In his interview, the partner, while mentioning this case, noted that it is crucial for current and incoming auditors to be fully aware of the firm's culture and understand how much professional skepticism should be appropriately applied to each audit engagement. Alongside this response, a local partner concerned over the idea that there tends to be a lack of follow-up, inquiry or procedures with various management assertions. As he had mentioned, auditors need to steer away from this "trust based on experience" notion. Simply because a top management member has been recording or valuing inventory with the same specific procedure does not necessarily mean it is accurate reporting and not fraudulent. There is also concern over the obvious disconnect between audit evidence one obtains in one area of the financials compared to another.

It seems as in this case and several others that the appropriate levels of professional skepticism were not adequately applied.

### **Suggestions for further research**

Overall, after meeting with professionals with varying levels of professional experience, it is evident that professional skepticism has become more heavily incorporated into the audit fieldwork since ten years ago. Newly hired auditors are arriving with more of an idea of what professional skepticism is and how crucial it is to his or her fieldwork.

There are several suggestions that can be proposed for future research on professional skepticism. In my analysis, I observed that there was not a clear distinction concerning the difference between training and experience in regards to the qualities that help develop auditor professional skepticism. Training and experience can be similarly related to one another. Furthermore, firm training can consist of specific training on professional skepticism, but training can also occur in an “on-the-job” setting.

Further research efforts on professional skepticism should consider focusing on not the most experienced professionals in the industry, but perhaps the newly hired audit associates. My questionnaire results illustrate that newly hired auditors are arriving into the profession with increased awareness about professional skepticism and the importance of detecting errors or fraudulent misrepresentations. This is due to college institutions placing more importance on professional skepticism and teaching university students about the results of Enron and Arthur Anderson. A University instructor who participated in this study notes that students are hearing more about professional skepticism in the classroom setting along with campus meetings with accounting professionals, but is this enough introduction to professional skepticism to be successfully applied to real-life audit work? Dr. Larry Rittenberg, a Professor Emeritus from the

University of Wisconsin-Madison, comments on how school programs should focus on incorporating more analysis into the Accounting curriculum. This can help steer away from the simple task of memorization of rules and/or standards (Rittenberg, 2012).

Dr. Rittenberg also notes that the PCAOB can contribute to the student's development of professional skepticism. Rittenberg believes that the PCAOB can publish their analysis and inspections of various Accounting standards and incidents. PCAOB publications of analysis and research can help teach students the importance of professional skepticism and help future auditors establish the appropriate behavior to apply in the planning and conducting of an audit (Rittenberg, 2012). In general, future research can explore different University curriculum and determine what more successfully promotes students to inherit a questioning mindset and skepticism behavior, whether that is through case studies, audit-based simulations, etc.

This professional skepticism questionnaire may further validate the idea that the current state of professional skepticism is more than 5 or even 10 years ago, but further research should explore the level of emphasis professional skepticism has received in the firm setting and in general. There seems to be a general consensus that there is a larger emphasis on professional skepticism, but further research should determine if professional skepticism has gone to an extreme level. For example, is there now somewhat of an overreaction in regards to professional skepticism? It may be beneficial to progress the professional skepticism used in the financial statement audits, but professionals may fear that accounting policies and firms are encouraging staff to apply too much of a skeptical mindset and questioning manner.

In addition, there is a cost benefit to, or perhaps an additional cost budget line item, to increasing professional skepticism at the firm level. Emphasizing professional skepticism requires more training and money spent on expanding the preliminary planning of an audit and

the conducting of the actual audit. Also it is crucial that auditors present an appropriate balance and degree of professional skepticism to management. An extreme measure of skepticism may result in challenging too many management assertions and lead to the risk of incurring unnecessary costs (Auditing Practices Board, 2011). A professional who participated in this research study notes that the CPA firm needs to ensure there is an appropriate level of balance among the amount of testing performed on the engagement, and the concern/need to be profitable on the client engagement. A professional from New Zealand, Zowie Murray, comments on the importance of balance when illustrating professional skepticism to avoid the possibility of over-auditing. Murray states, "Professional skepticism is central to audit quality, but a balance must be struck between practicality and doubt" (Murray, 2012). Therefore, future research on professional skepticism should study the cost benefit to the evident higher level of professional skepticism in the industry today. The current state of professional skepticism may have come forth with high costs, but has definitely been effective in aiming to avoid fraudulent financial reporting.

## **Conclusion**

In this research paper, I have taken a closer look at the current perceptions of professional skepticism among professionals who were once in the public accounting industry and professionals who are currently in the profession. The five professionals who participated in this questionnaire are auditors who were once in or currently in the industry in public Accounting firms ranging from Big Four firms to small local firms. Due to the nature of the specifics of the questions that were answered, these case studies will remain anonymous due to the confidential nature of the findings.

The overall general perception among all former and current professionals is that the current state of professional skepticism is more than it was approximately ten years ago at the beginning of the implementation of SOX in 2002. Therefore, it is evident there was a noticeable focus on professional skepticism in the industry immediately after the huge scandals from the early 2000's. Furthermore, professional skepticism is said to be applied more effectively through increased experience in various audit engagements, but professionals believe that firm on-the-job training and case studies help auditors determine the qualities that compose this questioning mindset and critical assessment of client evidence. It is viewed as difficult to entirely "train" professional skepticism into today's auditors and therefore is more beneficial with experience with all levels of the audit engagement. However, due to the different responses in regards to who is more likely to illustrate professional skepticism, it seems evident that professional skepticism is becoming increasingly more applied at all levels of the engagement from associate to partner.

In general, accounting regulations and firms have placed a larger emphasis on the importance of professional skepticism over the years. The impact professional skepticism will have on the industry and audit engagements are unknown. Will firms and professionals start to overreact to the amount of professional skepticism that should be applied to all audits? Will professionals start to think there is an overreaction to professional skepticism during the planning and work phases of the audit? Professional skepticism may always be a critical component of an audit, but the industry may believe newly hired auditors are coming in with awareness of the questioning mindset that is needed for auditing and cut back on trainings for professional skepticism. Overall, although it is up to the auditor to always use his or her own professional



judgment and act in the most responsible manner, the accounting profession definitely needs to continue to help promote and emphasize this crucial approach to auditing.

## **Appendix A**

### ***Professional Skepticism Questionnaire***

***Name:***

***Title:***

#### **Questions:**

1. What do you believe is the current state of professional skepticism?  
For example,
  - More or less professional skepticism than 5 years ago?
  - More or less professional skepticism than 10 years ago?
2. In the past, did newly hired auditors arrive in the profession with more or less professional skepticism than newly hired auditors today?
3. Which quality is more important in the development of auditor professional skepticism?
  1. Training
  2. Experience
  3. Inherent Trait
4. Who is more likely to illustrate professional skepticism in the firm setting (i.e. partner, senior manager, manager, senior, staff associate)?
5. Do you believe there needs to be more concern over professional skepticism from the firms?
6. What actions can be taken at the firm level to help increase auditors' levels of professional skepticism (i.e. bringing more awareness of the importance of professional skepticism)?
7. For any fraud cases that you are aware of, do you think that a significant amount of professional skepticism was applied? Or do you believe that an increased level of professional skepticism might have helped detect misstatements sooner?

## Works Cited

- ACCA, and ACRA. "Talent Attraction and Retention in Larger Accounting Firms." N.p., Aug. 2012. Web. 20 Apr. 2014. <<http://www.accaglobal.com/content/dam/acca/global/PDF/technical/other-PDFs/talent-attraction-singapore.pdf>>.
- "Auditor Skepticism: Raising the Bar." Financial Reporting Council (FRC), Aug. 2010. Web. 20 Apr. 2014. <<https://www.frc.org.uk/getattachment/2f2a1e0146-a92c-4b7e-bf33-305b3b10fcd2/2FDiscussion-Paper-Auditor-Scepticism-Raising-the-Ba.aspx>>.
- "Auditor Skepticism: Raising The Bar Feedback Paper." Financial Reporting Council (FRC), Mar. 2011. Web. 20 Apr. 2014. <<https://www.frc.org.uk/Our-Work/Publications/APB/Discussion-Paper-Auditor-Scepticism-Raising-the-Ba/Feedback-Paper.aspx>>.
- "Ancient Greek Skepticism." Internet Encyclopedia of Philosophy (IEP). N.p., n.d. Web. 20 Apr. 2014. <<http://www.iep.utm.edu/skepanci/>>.
- Bagley, Penelope L., Derek Dalton, and Marc Ortegren. "The Factors that Affect Accountants' Decisions to Seek Careers with Big 4 Versus Non-Big 4 Accounting Firms." *Accounting Horizons* 26.2 (2012): 239-64. ProQuest. Web. 20 Apr. 2014.
- Bazerman, Max H., Kimberly P. Morgan, and George F. Loewenstein. "The Impossibility of Auditor Independence | MIT Sloan Management Review." *MIT Sloan Management Review* RSS. N.p., 15 July 1997. Web. 20 Apr. 2014. <<http://sloanreview.mit.edu/article/the-impossibility-of-auditor-independence/>>.
- Beasley, Mark S., Joseph V. Carcello, Dana R. Hermanson, and Terry L. Neal. "An Analysis of Alleged Auditor Deficiencies in SEC Fraud Investigations: 1998 - 2010." Center for Audit Quality (CAQ), May 2013. Web. 20 Apr. 2014.
- Beasley, Mark S., Joseph V. Carcello, and Dana R. Hermanson. "Top 10 Audit Deficiencies." *Top 10 Audit Deficiencies. Journal of Accountancy*, Apr. 2001. Web. 20 Apr. 2014.
- Brickner, Daniel R., and Michael A. Pearson. "SAS 99." *Fraud Magazine*. N.p., May 2003. Web. 20 Apr. 2014.
- Bukics, Rose Marie L., and John M. Fleming. "Fraud Detection: SAS 99 Increases Auditors' Responsibilities." *PICPA*. N.p., Winter 2003. Web. 20 Apr. 2014. <<http://www.picpa.org/Content/cpajournal/2003/winter/10.aspx>>.
- Carpenter, Tina D., and Jane L. Reimers. "Professional Skepticism: The Effects Of A Partner's Influence And The Level Of Fraud Indicators On Auditors' Fraud Judgments And Actions." *Behavioral Research In Accounting* 25.2 (2013): 45-69. Business Source Premier. Web. 20 Apr. 2014.

- Cottrell, D. and Glover, S. "Finding auditors liable for fraud: What the jury heard in the PharMor Case", The CPA Journal Pages 14-21, 7, 1997."Examining the Roots of Skepticism: Pyrrho and Sextus." For Dummies. N.p., n.d. Web. 20 Apr. 2014. <<http://www.dummies.com/how-to/content/examining-the-roots-of-skepticism-pyrrho-and-sextu.html>>.
- Franzel, Jeanette M. "Professional Skepticism and High Quality Audits." 2014 Accounting Education Conference. Columbia, MD. 10 Jan. 2014. Lecture.
- Glover, Steven M., and Douglas F. Prawitt. Enhancing Auditor Professional Skepticism. Global Public Policy Committee, Nov. 2013. Web. 20 Apr. 2014. <<http://www.theacaq.org/docs/research/skepticismreport.pdf>>.
- Hurt, Kathy. An Experimental Examination of Professional Skepticism. Thesis. Baylor University, 2008. N.p.: n.p., n.d. An Experimental Examination of Professional Skepticism. May 2008. Web. 20 Apr. 2014.
- Hurt, R. Kathy, et al. "Research On Auditor Professional Skepticism: Literature Synthesis And Opportunities For Future Research." Auditing 32.(2013): 45-97. Business Source Premier. Web. 20 Apr. 2014.
- International Auditing and Assurance Standards Board. "Staff Question and Answers." International Federation of Accountants, Feb. 2012. Web. 22 Apr. 2014. <<http://www.ifac.org/sites/default/files/publications/files/IAASB%20Professional%20Skepticism%20QandA-final.pdf>>.
- Kim, Jim. FierceComplianceIT Newton: Questex Media Group LLC. (Aug 15, 2013).
- Marczewski, Donald C; Akers, Michael D. CPAs' Perceptions of the Impact of SAS 99. The CPA Journal 75.6 (Jun 2005): 38-40.
- Murray, Zowie. "GAA Accounting." GAA Accounting. N.p., 12 Oct. 2012. Web. 20 Apr. 2014. <<http://read.gaaaccounting.com/news/the-pros-and-cons-of-professional-scepticism/>>.
- Murray, Zowie. "Professional Skepticism." Journal, Dec. 2012. Web. 20 Apr. 2014. <<http://www.hayesknight.co.nz/media/74087/professional%20scepticism.pdf>>.
- Nelson, Mark W. "A Model and Literature Review of Professional Skepticism in Auditing." Auditing 28.2 (2009): 1-34.ProQuest. Web. 20 Apr. 2014.
- Nichols, Linda M. "Accounting Practices in U.S. Public Companies." Accounting Practices in U.S. Public Companies. The CPA Journal Online, Nov. 2006. Web. 23 Apr. 2014. <<http://www.nysscpa.org/cpajournal/2006/1106/essentials/p28.htm>>.

Public Company Accounting Oversight Board (PCAOB). Staff Audit Practice Alert No. 10: Maintaining and Applying Professional Skepticism in Audits. PCAOB, 4 Dec. 2012. Web. 20 Apr. 2014. <[http://pcaobus.org/Standards/QandA/12-04-2012\\_SAPA\\_10.pdf](http://pcaobus.org/Standards/QandA/12-04-2012_SAPA_10.pdf)>.

Rittenberg, Larry E. Comments on Governance, Professional Skepticism, and Auditor Independence. N.p., 10 Oct. 2012. Web. 20 Apr. 2014. <[http://pcaobus.org/Rules/Rulemaking/Docket037/ps\\_Rittenberg.pdf](http://pcaobus.org/Rules/Rulemaking/Docket037/ps_Rittenberg.pdf)>.

Tysiac, Ken. "PCAOB Alert Says Audits Must Be Conducted with Skeptical Eye." PCAOB Alert Says Audits Must Be Conducted with Skeptical Eye. *Journal of Accountancy*, 4 Dec. 2012. Web. 20 Apr. 2014. <<http://www.journalofaccountancy.com/News/20126953.htm>>.