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Masterclass by Kris Hardies and Sanne Janssen on 'Professional Skepticism'

Kris Hardies is associate professor at the University of Antwerp. Sanne Janssen is lecturer at the Open Universiteit. Professional skepticism is a focal area of their research.

The research they present is based upon the FAR research project "Professional skepticism profiles, effects on audit processes and outcomes, and the moderating role of audit firm culture" on which they collaborate with Ann Vanstraelen (Maastricht University) and Karla Zehms (University of Wisconsin-Madison).

On October 9 2019, Kris Hardies and Sanne Janssen presented their FAR-masterclass on professional skepticism. Professional skepticism is an important topic, which is high on the agenda of regulators and policy makers. A lack of professional skepticism appears to be related to insufficient audit quality. In this masterclass, the importance and difficulties were discussed of applying professional skepticism during an audit. In addition, some insights from current research were presented. Furthermore, potential ways to improve professional skepticism were considered.

What is professional skepticism?
As Arnold Schilder (then Chairman of the IAASB) said in 2012: 'the need for professional skepticism in an audit cannot be overemphasized'. But what do we mean by professional skepticism? This was asked to the audience members, who discussed the question in small groups. Key words that came up were: independence, questioning mind, challenging the obvious, weigh contradictory evidence and being aware of your own biases. These words resemble to a major extent what's being said in the literature. Hardies distinguished three definitions of professional skepticism: (1) to have a questioning mind and critically assess audit evidence; (2) to have more doubt about the validity of an assertion than about its invalidity; and (3) to have a mindset and an attitude which are driven by individual determinants and social and situational determinants. The latter definition recognizes that personal and situational characteristics lead to a psychological state, which in turn influences behavior. According to the presenters, this last definition is the most complete and viable definition of skepticism.

But what are the most important drivers of professional skepticism, considering individual determinants and social and situational determinants? Discussion in small groups resulted in the following drivers: commercial incentives, lack of experience, curiosity, professional judgment, self-confidence, independence, pressure, client as well as audit firm climate, confidence, institutional context, ethical values, training/coaching, tone at the top and courage. Some of these drivers are situational, others relate to personality characteristics.

Situational characteristics
Situational characteristics can be split into organizational characteristics and environmental characteristics. Both of these types of situational characteristics are important for professional skepticism.

Organizational characteristics
Organizational characteristics typically refer to, for example, the audit firm's internal quality control system (e.g. how people are evaluated and promoted), the learning climate (e.g. how is responded to errors within the firm) and tone at the top. These were the organizational characteristics that were further elaborated upon during the session.

(1) Internal quality control system

Hardies linked potential internal quality control issues regarding professional skepticism to the outcome bias. The outcome bias is the cognitive bias which refers to the tendency to judge a decision by its eventual outcome (instead of the quality of the decision at the time it was made). Research shows that reviewers penalize auditors who employ an appropriate level of skepticism, but do not identify a misstatement (Brazel et al. 2016). Auditors who did identify a misstatement were judged to have shown a better performance, while their actions were exactly the same. Hence, current evaluation systems may inadvertently discourage skepticism among auditors in the field. It is hard to mitigate the outcome bias, but, of course, we shouldn't want to penalize people for being skeptical.

(2) Learning climate

It is bound to happen that auditors make mistakes. The more important issue is how errors are managed within the audit firm. What is the response to the errors? Is there a blame culture? Or do firms try to learn from it, do they see errors as a learning opportunity? Research shows that auditors working in a supportive learning culture consistently engage in more professional skepticism (Grohnert et al. 2019). Hence, auditors should feel supported, even when making mistakes. A safe environment is important. Of course, audit firms have to create the appropriate learning environment, in which making errors is treated in a productive way. However, regulators should not prevent organizations from developing learning systems. They could learn from other professions, like medicine and aviation, in which learning from errors has been a focal topic much longer than in auditing. Of course, there is a difference between errors and violations. Violations are related to ethical misbehavior. They should be treated differently. Nevertheless, also with violations, a root cause analysis is important. Why did it happen? Is there a systematic reason for people to do it? Bottom line: auditors should not be blamed for unintentional errors. The error management climate should be geared towards that end.

(3) Tone at the top

Tone at the top is very important for a healthy culture of professional skepticism. Partner support increases commitment and leads to lower turnover. In their own research, Hardies and Janssen find that in 85 percent of the cases auditors feel supported by partners in their firm to behave professionally skeptical. And in 78 percent of the cases the auditors even feel supported if their skepticism leads to a conflict with the client. That is positive.

Environmental characteristics

Environmental characteristics refer to, for example, the auditing standards, time pressure, client preferences and commercial aspects. Auditors self-report that they work more hours than what they believe is good for audit quality, both during busy season and at other times (Persellin et al. 2019). In the research by Cohen et al. (2017), in about one

third of the examined cases, auditors report that there are not sufficient time, people and budget to exercise professional skepticism.

Personal(ity) characteristics

Next to the situational characteristics, personal characteristics have an important influence on professional skepticism, for example, skeptical traits, age, gender etc. Most participants during the session assess that lower-level auditors are the most skeptical in terms of traits. But what about the sample the research team examined? Existing scales from the literature were used to measure professional skepticism. To measure so-called neutral skepticism, the Hurtt Professional Skepticism Scale was used. This scale assesses to what degree the auditor has a questioning mind, is willing to suspend judgment, searches for knowledge, has interpersonal understanding, and has autonomy and self-esteem. A sample scale item is: 'I often accept other peoples' explanations without further thought'. To measure professional moral courage, the Professional Moral Courage Scale was used. Its definition states that auditors vary in their willingness to take skeptical actions and it is designed to assess whether an auditor has a desire to act and is able to make the decision to act. A sample scale item is: 'I act morally even if it puts me in an uncomfortable position with my superiors'. To measure the so-called presumptive doubt interpretation of professional skepticism, the reversed Rotter Interpersonal Trust Scale was used. It is designed to capture a generalized expectancy of an individual or group that the word, promise, verbal or written statement of another individual or group can be relied upon. A sample scale item is: 'In dealing with strangers one is better off to be cautious until they have provided evidence that they are trustworthy'.

Sample and findings of the research by Hardies, Janssen and co-researchers

Six Dutch audit firms participate in the project for which they delivered a sample of in total 342 engagements. 1447 auditors were selected to participate in the study of which 758 submitted a usable response. The sample consists of about 150 partners, 220 managers, 110 seniors and 270 juniors.

Findings concerning personality traits

First, the findings show that the mean score of the partners significantly differs from the other ranks, on all three scales. The results suggest that the partners have a higher neutral skepticism and higher moral courage, while for Distrust the mean score of partners is lower which means that partners have a lower level of presumptive doubt, they are more trusting. There are no significant differences across other ranks.

It was also asked how auditors perceive their 'relative' professional skepticism, compared to other auditors at the same rank. Auditors at all ranks perceive their skepticism to be higher than average. This is a general phenomenon which is called overconfidence bias, which apparently also holds for auditors when judging their degree of skepticism.

The participants' self-perceived level of professional skepticism correlates significantly with the scores on the HPS and PMC scales, but not with the reversed Rotter scale.

According to the reversed Rotter scale, partners perceive themselves to be more willing to take skeptical actions, while they are more trusting.

Findings concerning other personal factors
The team also collected data on other characteristics like gender, age, experience and knowledge. For the last three, the observed values increase simultaneously with rank. For gender, the number of females decreases when rank increases: 36 percent of juniors and 8 percent of partners are female. Concerning personality characteristics, again the results show that the personality of the partner significantly differs from the other ranks. Partners are more extravert, more conscientious, more emotionally stable and more open and narcissistic, but partners are less Machiavellian and psychopathic. The managers are more emotionally stable and less Machiavellian, compared to seniors and juniors. There are no significant differences between seniors and juniors.

Findings concerning fraud brainstorming
An important second goal of the project is to study whether professional skepticism really matters for the audit process. Therefore, there were questions included concerning fraud brainstorming (indicating brainstorming quality, fraud risk factors and risk responses), regarding valuation and resolving related uncertainties, and about analytical procedures used in a specific engagement.

Evaluating fraud brainstorming quality is important. Studies have shown that higher fraud brainstorming quality leads to more effective audit plans to identify misstatements due to fraud. Fraud brainstorming quality is measured by use of the 21-item measure of Brazel et al. (2010) (e.g., did a partner lead the sessions, did specialists attend the session, whether there was an agenda, the contribution of the participants, the duration of the sessions, the number of sessions), resulting in a brainstorm quality score and a higher score implies a higher fraud brainstorming quality.

The researchers looked at the correlation between the trait skepticism scores of the partners and fraud brainstorming quality. Partners with a high score on the HPS and PMC scales show higher brainstorming quality than partners with a low score (split by median). For Distrust, the opposite holds: partners with a higher score on distrust show a lower quality score.

For partners with higher scores on the HPS and PMC scales, the research team observed that they 'experienced' more contribution during the brainstorming session(s), they had more specialists attending the session(s), there was more preparation and the session(s) lasted longer. Specifically for PMC, concerning partners, higher scores relate to more extensive discussion. For Distrust, partners with a higher score more often led the session(s) themselves and planning the preparation and the duration of the session(s) took less time, compared to partners with a lower score on Distrust.

Preliminary evidence at the team level shows that skepticism traits of seniors and juniors do not impact fraud brainstorming quality. Further, it shows that especially the neutral trait skepticism of the manager and the professional moral courage of the partner is associated with fraud brainstorming quality. So professional skepticism traits at different levels could have a different impact. However, these analyses are preliminary, not considering yet any confounding factors.

For valuation, the question 'to what extent did you resolve the uncertainty about a particular valuation or judgment?' was included in the survey. The results show that auditors with a high score on the HPS and PMC scales, to a larger extent attempt to resolve uncertainties by means of, for example, collecting additional evidence and seeking advice from specialists. For Distrust, no results were found.

Regarding analytical procedures, the question was asked 'to what extent did you use the following analytical procedures for a particular engagement?' (for example: 'I developed formal quantitative expectations for account balances'). Again, the findings show that auditors with high scores on the HPS and PMC scales made more use of the analytical procedures, compared to the low score group. And there was no difference for Distrust.

Key takeaways
It is very interesting to study how professional skepticism profiles of different ranks interact with audit firm organizational conditions in leading to audit processes and audit outcomes.

We should encourage people within firms to act skeptically, or at least do not penalize professional skepticism. This could be taken care of with: proper evaluations; partner and supervisor's support; and the need for sufficient time, budget and people. If we are really serious about audit quality, these are areas that require attention.

Concerning personal characteristics, the key takeaways are that PS traits do seem to have an impact on audit processes. Furthermore, there is quite a lot of variation in PS profiles between ranks and within ranks. If firms are more aware of this, it could be used in the selection processes and promotion decisions. And maybe they already do.