



**Institute of
Chartered Accountants
Australia**

Practical Ways to Improve the Exercise and Documentation of Professional Skepticism in an ISA Audit

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Practitioners are expected to use professional judgment in determining whether and how to apply the suggestions contained in this paper.

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Introduction and purpose of the paper

A high-quality audit requires the exercise of professional judgment by the auditor and a mindset of professional skepticism. Because it is part of the auditor's mindset, professional skepticism depends on the personal behavioural traits of those involved in the audit and is influenced by such things as the motivation, competencies, education, training and experience of each auditor.

The International Standards on Auditing (ISAs) note that professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in light of the circumstances.

Evidencing the exercise of professional skepticism is critical in demonstrating that the audit was planned and performed in accordance with ISAs.

Audit inspectors throughout the world have expressed concern about whether professional skepticism is being applied properly in practice. For example, they have commented that some auditors have:

- not responded appropriately in circumstances when inconsistent or contradictory audit evidence was obtained;
- been over-reliant on management representations;
- sought audit evidence to corroborate rather than challenge management's assertions; or
- accepted unreliable audit evidence as being sufficient and appropriate.

The ISAs require the auditor to prepare sufficient audit documentation to enable an experienced auditor, having no previous connection with the audit, to understand, among other things:

- the results of the audit procedures performed and the audit evidence obtained; and
- significant matters arising during the audit, the conclusions reached thereon and significant professional judgments made in reaching those conclusions.

Further, if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor must document how the auditor addressed the inconsistency.

The ISAs note that there may be no one way in which the auditor's professional skepticism is documented. Nevertheless, the audit documentation may provide evidence of the auditor's exercise of professional skepticism in accordance with the ISAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.

The purpose of this paper is to provide one practical approach for practitioners to enhance the exercise of professional skepticism in an audit of financial statements and reflect this in the audit documentation.

The topic of professional skepticism can be scoped very broadly. This paper does not attempt to address all matters. For example, the paper excludes actions that might be taken at the firm level that could foster and enhance the exercise of professional skepticism, such as through recruitment, formal training, incentive mechanisms, or performance evaluations. The paper is developed in the context of an engagement team made up of members with varying experience, training and professional skepticism. Those encountering other aspects, such as a sole practitioner, or group audit situations involving group and component auditors, may find the suggestions in this paper useful in addressing their circumstances.

Key questions in developing a practical approach to enhancing professional skepticism

Do the different roles played by persons involved in the engagement affect how they exercise professional skepticism?

Members of the engagement team, and others providing assistance on the audit, do have different roles in relation to exercising professional skepticism. For example:

- The *engagement partner*. The engagement partner sets the tone for the engagement, including the exercise of professional skepticism. The engagement partner brings extensive experience to bear in assessing whether professional skepticism was exercised appropriately throughout the audit by other members of the engagement team, as well as by experts and consultants who have provided input to the engagement.
- *Those who perform a review function* during the audit, such as audit supervisors or managers. Audit supervisors have the experience to challenge the work performed by more junior staff and assist in integrating the findings of different engagement team members.
- *Those who are responsible for performing audit procedures and gathering audit evidence*. Although less experienced, such team members face multiple opportunities during an audit to appropriately exercise professional skepticism.

- *Auditor's experts and consultants who provide input to the engagement team.* Communications with experts and consultants, and review of their work, takes into account that not all experts and consultants will necessarily have the same education, training and experience as members of the engagement team in exercising professional skepticism.
- The *engagement quality control reviewer*. The engagement quality control reviewer provides an objective evaluation of the significant judgments made by the engagement team and conclusions reached. They are in a key position to determine whether professional skepticism was appropriately exercised by the engagement team.

What actions can be taken to enhance the exercise of professional skepticism during an engagement?

The four elements of professional skepticism set out in paragraph A18 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, address this issue. The paragraph states that professional skepticism includes being alert to:

- audit evidence that contradicts other audit evidence obtained;
- information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence;
- conditions that may indicate possible fraud; and
- circumstances that suggest the need for audit procedures in addition to those required by the ISAs.

How can professional skepticism be better demonstrated in an engagement?

Because professional skepticism is influenced by personal behavioral traits and individual competence, demonstrating how professional skepticism was exercised is often problematic in an engagement. This paper suggests how documentation might be enhanced to more clearly demonstrate how professional skepticism was exercised by those involved in the engagement throughout the engagement.

How the approach set out in this paper can enhance the exercise and documentation of professional skepticism

There are many reasons why there may be an actual or perceived lack of professional skepticism exercised on some engagements. The following are challenges to enhancing the exercise and documentation of professional skepticism at the engagement level and provide a basis for the approach set out in this paper:

- *Establishing a clearer link between the exercise of professional skepticism and the sufficiency and appropriateness of evidence obtained.* Actions taken during the engagement may demonstrate professional skepticism but are not necessarily documented because they are considered not to be contributing to sufficient appropriate audit evidence. The approach in this paper encourages the documentation of these actions.
- *Exercising professional skepticism throughout the engagement.* Professional skepticism needs to be exercised throughout the engagement but may not always be top of mind. To promote this mindset, frequent stand-back reviews during all phases of the engagement by all members of the engagement team are suggested.
- *Establishing effective interaction among senior and junior staff in exercising professional skepticism.* Senior engagement personnel may not understand how to encourage the exercise of professional skepticism by junior staff. The approach in this paper may help reinforce the role of senior personnel in this respect.
- *Ensuring that the benefits of the additional documentation of the exercise of professional skepticism outweigh related costs.* The ISAs and International Standard on Quality Control 1 (ISQC 1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statement, and Other Assurance and Related Services Engagements*, already contain extensive documentation requirements. On the cost side, documentation of professional skepticism suggested in this paper is intended to be integrated, where practicable, with existing documentation that complies with the ISAs without creating a significant additional documentation burden. On the benefits side, this paper suggests documenting specific actions that demonstrate the exercise of professional skepticism to facilitate quality control reviews and audit inspections. It avoids the use of boilerplate or trite phrases (e.g., “I have been professionally skeptical”) that do little to obtain sufficient appropriate audit evidence.

- *Establishing a feedback loop from the exercise of professional skepticism on individual engagements to the firm's overall initiatives to improve professional skepticism.* Firms often provide staff training on professional skepticism but it is difficult to gauge how effective such training was in practice. The approach in this paper may help strengthen the understanding of those involved in the engagement of how to apply that training in practice and provide useful feedback to improve such training.

Overview of the approach

This paper sets out a series of questions that were developed for different phases of the engagement. The questions are based on the four elements of professional skepticism noted above and are designed to reflect the different roles and levels of those involved in an engagement.

The suggested questions are generally open ended to promote responses that demonstrate how professional skepticism was exercised in the engagement. Considerations and examples elaborate on the questions presented. Suggestions are also made as to how the responses to the questions posed may be documented.

There are different ways of incorporating the questions and the related responses into audit documentation. One approach might involve the preparation of individual self-review questionnaires that would be integrated to readily enable reviewers obtaining an overall understanding of how professional skepticism was exercised in the audit and drill down to any level of detail they consider appropriate. The [Professional Skepticism Question Series](#) examples can form the basis of these self-review questionnaires. There are advantages and disadvantages with this approach. On the one hand, it would require additional documentation. On the other hand, this documentation may be more effective than other approaches in focusing attention to the exercise of professional skepticism, particularly in high risk areas of the audit where the exercise of professional skepticism is critical.

Another approach might be to incorporate the questions into other existing forms or worksheets used in the engagement. The paper provides an illustration of a [Team Planning Discussion Worksheet](#), which incorporates a section (section 6) dealing with professional skepticism. Such an approach would avoid significant additional documentation. However, it would require adaptation of existing forms and worksheets.

These are just two possible approaches to documenting the exercise of professional skepticism and other approaches are possible. Each audit firm would need to develop its own approach based on its circumstances and recognizing the challenges to enhancing the exercise and documentation of professional skepticism identified in this paper.

Concluding comments

This paper proposes practical ways in which the exercise of professional skepticism can be enhanced in an audit of financial statements and reflected in audit documentation by setting out a series of questions for different phases of the engagement. Practical experience of using the questions may enable the questions to be refined and assist in identifying the best means of demonstrating the exercise of professional skepticism in an effective manner.

Appendix A:

Professional Skepticism Question Series

This section contains questions that may be asked by the respective individuals involved in an audit engagement during different phases of the engagement.

The questions are generally phrased as open questions to encourage other than Yes/No responses. Considerations and examples elaborate on the questions presented. Suggestions are made as to how the responses to the questions posed may be documented.

A. Enhancing professional skepticism during preliminary engagement activities and planning the engagement

A: Questions for the engagement partner and other key engagement team members to consider

1. What actions to eliminate threats to independence, or reduce them to an acceptable level, were taken that will enhance the professional skepticism of the team?
 2. What factors may affect the ability of the engagement team to exercise appropriate professional skepticism during the audit?
 3. How has the direction, supervision and performance of the engagement been planned to promote the application of professional skepticism by all of the team?
 4. How have areas where the use of professional skepticism will be critical to the audit been communicated to the engagement team?
-

Examples of actions to take in answering the questions

- Facilitate planning meetings that include a focus on the appropriate exercise of professional skepticism.
 - Explain what is meant by professional skepticism and how it applies to this engagement.
 - Foster discussion among team members that allows less experienced members to raise questions in a non-threatening environment.
 - Ensure all team members understand the objectives of the assigned work, including those aspects of their particular assignments where professional skepticism is likely to be most important.
 - Identify the types of circumstances when less-experienced team members must consult on a timely basis with more experienced team members.
 - Explain how audit evidence obtained by individual team members will be aggregated and integrated and the importance of communication and cooperation in exercising professional skepticism.
 - Identify whether there are aspects of the audit of the prior year where, in retrospect, there is scope to improve the exercise of professional skepticism.
 - Discuss the relationship of the engagement team with management and client staff for the particular engagement, including:
 - how to balance the need to keep an appropriate working relationship with the client while maintaining a questioning mind; and
 - whether there are matters particular to this audit that need to be taken into account in dealing with client personnel; for example, should only senior engagement team members deal with certain client employees who are perceived as posing an intimidation threat to junior engagement staff?
 - Identify the higher risk areas of the audit that should be undertaken as early on as practicable in the audit so that time pressures near the end of the engagement will not adversely affect the exercise of professional skepticism. Such areas may be identified from the planning process, prior audits of the entity, or from audits of similar entities and related audit inspection reports that identify professional skepticism implications. Such areas may include valuations, going concern or related party transactions.
-

Suggestions on how responses may be documented

Questions A:1-4 and responses may be documented by way of a Preliminary Engagement Professional Skepticism Questionnaire (using the questions as a base) that is completed when documenting compliance with paragraphs 11, 14 and 15(a) of ISA 220, *Quality Control for an Audit of Financial Statements*, and paragraph 5 of ISA 300, *Planning an Audit of Financial Statements*.

B. Enhancing professional skepticism during the engagement

B1: Questions for the individuals performing audit procedures and gathering audit evidence to consider

1. What reasonable alternatives other than those put forward by management have I considered?
 2. What evidence have I obtained that supports management's assertions and what evidence does not support those assertions?
 3. Does the evidence I have obtained integrate with that obtained in other areas of the audit?
 4. How have I responded to identified discrepancies or inconsistencies?
 5. How do I know that the audit evidence I have obtained is reliable?
 6. What were the results of my stand-back review before concluding on the procedures performed and the evidence obtained?
 7. What is my basis for concluding on the sufficiency and appropriateness of the evidence I have obtained?
-

Examples of actions to take in answering the questions

- Obtain and apply an objective viewpoint in considering all reasonable alternatives. Management may have a biased view of possible alternatives. The extent to which alternatives need to be considered may be affected by matters such as:
 - the significance of the risks being addressed;
 - whether the alternatives put forward by the client are consistent with those of previous periods;
 - whether there are alternatives that management identified but rejected without apparent good reason;
 - whether there are alternatives not considered by management;
 - the complexity or subjectivity of the matter indicating the need to consult with more experienced engagement team members, consultants within the firm, or auditor's experts; and
 - the auditor's previous experience with similar items.
 - Use inquiry techniques that recognize the possibility of different perspectives on an issue and give appropriate consideration to each. The auditor may obtain audit evidence that supports but also evidence that contradicts management's assertions.
 - Consider whether evidence obtained in other areas of the audit either corroborates or is inconsistent, and resolve significant inconsistencies. It may be necessary to consult with senior members of the engagement team to help identify and/or resolve inconsistencies in evidence obtained. Resolution may require a change in the management's position, which may need to be escalated to the engagement partner for discussion with management and those charged with governance.
 - Where practicable, develop the auditor's own expectation of the outcome of the procedure before performing it. This enables the auditor to avoid being biased by the initial position taken by management. Identified discrepancies or inconsistencies may affect the auditor's assessment of the risks of material misstatement and other planned audit procedures. Conditions that indicate possible fraud need to be brought to the attention of the audit supervisor/manager.
 - Be alert for circumstances when audit evidence may have been tampered with (e.g., evidence obtained electronically in an unsecured manner). Representations from management on their own do not provide sufficient appropriate audit evidence about a matter.
-

B1: Questions for the individuals performing audit procedures and gathering audit evidence to consider

Examples of actions to take in answering the questions (continued)

- Stand back at appropriate times in performing each audit procedure and ask “Am I missing something?” In particular, a stand back helps in assessing why other alternatives were rejected.
 - Consider the sufficiency and appropriateness of audit evidence in relation to the risk of material misstatement and potential impact on shareholders. Do you have sufficient appropriate audit evidence to be able to conclude on management’s assertions such as existence, completeness and valuation?
-

Suggestions on how responses may be documented

Questions B1:1-7 and responses may be documented by way of a Staff Professional Skepticism Self-Review Questionnaire (using the questions as a base) when meeting the documentation requirements in paragraph 8 of ISA 230, *Audit Documentation*.

B2: Questions for individuals performing a supervision or review function (the audit supervisor/manager) to consider

1. To what extent do the conclusions reached accord with my own expectations?
 2. How do I know that staff reached conclusions in an unbiased manner?
 3. To what extent is the audit evidence obtained sufficient and appropriate in relation to the assessment of the risks of material misstatement?
 4. How were inconsistencies or contradictions identified and appropriately resolved?
 5. To what extent have any implications for other aspects of the audit been identified and communicated to those responsible and where are they evidenced?
 6. Has my stand-back review of the audit work performed identified anything that is not appropriately documented in the file?
 7. What support do I have to conclude on the sufficiency and appropriateness of the evidence obtained? For example, am I satisfied that I have seen clear evidence to support management's assertions such as completeness, existence, rights and obligations, and valuation for each material item?
-

Examples of actions to take in answering the questions

- Challenge the conclusions reached by less-experienced team members. Such challenges will be based, for example, on the insights and experience the supervisor has obtained from being involved in other aspects of the audit or other audits of similar entities.
 - Challenge any indication that staff has accepted the representations of management without considering the need to corroborate them with other audit evidence. Staff may have inappropriately discounted evidence that contradicts management's assertions.
 - Identify and resolve doubts about the reliability of audit evidence obtained, including, for example, contradictions or inconsistencies in the audit evidence obtained that less-experienced staff may either not have identified or not appropriately resolved through other audit procedures. For example, findings in one area may indicate potential management bias that may need to be considered in relation to findings in other areas of the audit, or may indicate the need to revise risk assessments and related audit procedures. Indicators of possible fraud need to be specifically addressed. It may also be useful to rank the types of audit evidence obtained based on various factors (e.g., relative reliability of the source of the evidence).
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Suggestions on how responses may be documented

Responses to questions are often best obtained through a review of the audit working papers in conjunction with an engaged discussion between the audit supervisor/manager and staff. Questions B2:1-7 and responses to this discussion may be documented by way of an Audit Supervisor Self-Review Questionnaire (using the questions as a base) and/or by enhancing the existing documentation prepared by other engagement team members (e.g., through preparation of additional memoranda).

The audit supervisor/manager that is responsible for a number of different aspects of an audit may need to summarize and integrate the Audit Supervisor Professional Skepticism Self-Review Questionnaires for those aspects of the audit into an overall summary to facilitate the engagement partner's review of how professional skepticism was applied in key parts of the audit.

C. Enhancing professional skepticism near the end of the engagement

C1: Questions for the engagement partner to consider

1. To what extent do the conclusions reached accord with my own expectations?
 2. How have I satisfied myself that any implications for other aspects of the audit were identified and addressed?
 3. How have I satisfied myself that inconsistencies and contradictions were identified and addressed?
 4. How have I satisfied myself that conditions that indicate potential for fraud were identified and addressed?
 5. How have I satisfied myself that appropriate additional audit procedures were performed when warranted?
 6. How have I satisfied myself that professional skepticism was applied by engagement team members in obtaining sufficient appropriate audit evidence?
 7. Have those charged with governance been informed of areas where appropriate exercise of professional skepticism was critical in assessing the sufficiency and appropriateness of audit evidence obtained?
-

Examples of actions to take in answering the questions

- Challenge the conclusions reached by team members. Such challenges will be based on, for example, the insights and experience the engagement partner has obtained from being involved in other aspects of the audit, or other audits of similar entities.
 - Perform a stand-back review of how professional skepticism was applied in key aspects of the engagement to support the engagement partner's conclusion that the audit opinion was supported by sufficient appropriate audit evidence. For example, consider performing a walk-through to understand how the engagement team has responded to significant risks and other risks of material misstatement. Such a walk-through may involve challenging staff as to how they have applied professional skepticism during the engagement and where this is evidenced in the file.
 - Communicate with those charged with governance when the auditor has faced challenges in exercising professional skepticism during the audit, as it may assist the audit committee fulfill its responsibility for oversight of the financial reporting process. It may also allow those charged with governance to assist the auditor in identifying appropriate sources of audit evidence.
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Suggestions on how responses may be documented

Questions C1:1-6 and responses may be documented in an Engagement Partner Professional Skepticism Walk-Through Questionnaire (using the questions as a base) as part of documenting compliance with paragraph 17 of ISA 220, *Quality Control for an Audit of Financial Statements*.

Communicating about professional skepticism with those charged with governance may be documented when documenting compliance with the requirements in ISA 260, *Communication with Those Charged with Governance*.

C2: Questions for the engagement quality control reviewer (EQCR) to consider

1. To what extent do the significant judgments and conclusions reached by the engagement team reflect the appropriate exercise of professional skepticism?
 2. How have I satisfied myself that selected audit documentation I have reviewed related to the above matters reflects the appropriate exercise of professional skepticism?
 3. How have I satisfied myself during discussions of significant matters with the engagement partner that professional skepticism was exercised?
-

Examples of actions to take in answering the questions

- In performing the quality control review required by paragraph 20 of ISA 220, *Quality Control for an Audit of Financial Statements*, objectively evaluate of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report, including specific consideration of whether there is evidence that appropriate professional skepticism was exercised by the engagement team in making those judgments.
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Suggestions on how responses may be documented

Questions C2:1-3 and responses may be documented in an EQCR Professional Skepticism Questionnaire, as part of documenting compliance with paragraph 20 of ISA 220.

Appendix B: Illustration of a Team Planning Discussion Worksheet

Entity _____ Period ended _____

Date/time of discussion _____ 20 ____

Attendees _____

Objective: *To discuss among the engagement team the susceptibility of the entity's financial statements to material misstatement and to develop a responsive and efficient audit strategy.*

Agenda	Notes and decisions reached	W/P Ref.
1 Discuss the nature of the entity, users of the financial statements, materiality, changes in operations, key personnel and areas to watch. Also address: (a) timing and scope of engagement; (b) etc.		
2 Discuss the susceptibility of the entity's financial statements to material misstatement due to fraud or error. Consider: (a) material balances and transactions; (b) etc.		
3 Identify the potential for fraud. (Consider developing specific fraud scenarios.) Refer to step 2 above and discussions about fraud with management. Also consider: (a) known instances of fraud that has occurred in the past; (b) etc.		
4 Discuss potential audit efficiencies: (a) reducing work performed where the risk of material misstatement is low; (b) etc.		

<p>5 Discuss and agree on the overall audit strategy. Consider:</p> <ul style="list-style-type: none"> (a) nature of risk assessment procedures required; (b) etc. 		
<p>6 Discuss the means of enhancing professional skepticism. Consider:</p> <ul style="list-style-type: none"> (a) whether specific actions are needed to enhance professional skepticism (e.g., has senior engagement staff dealt with difficult client employees); (b) focusing on high risk areas earlier in the engagement to avoid potential time pressures; (c) circumstances where engagement team members are likely to need to consult more senior team members (e.g., when reviewing management assumptions about complex accounting estimates); (d) how audit evidence will be integrated across the whole engagement team (e.g., to identify contradictions and inconsistencies); and (e) areas arising from planning, prior audits of the entity or from similar entities, and related audit inspection reports where concerns may arise about the need for professional skepticism (e.g., when evaluating the reliability of audit evidence). 		

Describe action steps arising from meeting	Who is responsible	Deadline	Actual completion

All significant matters raised during the audit planning meeting are documented above.

Reviewed by _____ Date _____

Final sign-off

All matters identified for action above (action steps) were completed.

Reviewed by _____ Date _____