

# Professional Skepticism: A Snapshot of Provisions in the Standards on Auditing

(Contributed by Auditing & Assurance Standards Board Secretariat.)<sup>1</sup>

The Standards on Auditing (SAs) contain objectives, requirements and application, and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The SAs require the auditor to exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit. The Standards also require the auditors to, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

The Standard on Auditing (SA) 200, Overall Objectives Of The Independent Auditor And The Conduct Of An Audit In Accordance With Standards On Auditing, defines the term **Professional Skepticism** as “An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence”.

The auditor, therefore, needs to plan and perform an audit with professional skepticism, recognising that circumstances may exist that cause the financial statements to be materially misstated. Professional skepticism includes being alert to, for example:

- 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.

- Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

Thus, among other things, exercising professional skepticism helps the auditor to reduce the risks of matters critical to an effective audit, such as:

- Overlooking unusual circumstances.
- Over generalising when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Exercise of professional skepticism is also necessary in the critical assessment of audit evidence and 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 the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

The application of professional skepticism enhances the effectiveness of an audit procedure and of its application and reduces the possibility that the auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. The concept of professional skepticism is also closely integrated with exercise of professional judgement by the auditor. Professional judgment refers to application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement. Exercise of both professional skepticism and professional judgment are indispensable elements of ensuring audit quality.

<sup>1</sup> The views presented herein do not necessarily represent the views of the Auditing & Assurance Standards Board. For feedback, please email: [aasb@icai.org](mailto:aasb@icai.org)

### Standards on Auditing (SAs)

The Standards on Auditing issued by the Institute of Chartered Accountants of India are principle based rather than rule based. Thus, these Standards, at many places envisage exercise of professional skepticism and professional judgment in application of the principles/ requirements enunciated therein. The following is

an extract from the various such SAs which contain specific requirement for application of professional skepticism by the auditor. The extract is for the ready reference of the readers and is not meant to be a substitute for the authoritative text of the SAs issued by ICAI.

Context	Requirement	Application
<b>SA 220: Quality Control For An Audit Of Financial Statements</b>		
<i>Direction, Supervision and Performance</i>	<p>15. The engagement partner shall take responsibility for:</p> <p>(a) The direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements; and (Ref: Para. A13-A15, A20)</p> <p>.....</p>	<p>A13. Direction of the engagement team involves informing the members of the engagement team of matters such as:</p> <ul style="list-style-type: none"> <li>• Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with <b>professional skepticism</b> as required by SA 200.</li> </ul> <p>Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.</p> <ul style="list-style-type: none"> <li>• The objectives of the work to be performed.</li> <li>• The nature of the entity's business.</li> <li>• Risk-related issues.</li> <li>• Problems that may arise.</li> <li>• The detailed approach to the performance of the engagement.</li> </ul> <p>Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members, so that appropriate communication can occur within the engagement team.</p>
<b>SA 230: Audit Documentation</b>		
<i>Form, Content and Extent of Audit Documentation</i>	<p>8. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:</p> <p>(a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;</p> <p>.....</p> <p>.....</p>	<p>A7. Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:</p> <p>.....</p> <p>.....</p>

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		<ul style="list-style-type: none"> <li>• In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:</li> <li>• For example, there may be no single way in which the auditor’s professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor’s exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management’s responses to the auditor’s inquiries.</li> </ul>
<b>SA 240: The Auditor’s Responsibilities Relating To Fraud</b>		
<i>Responsibilities of the Auditor</i>	8. When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognising the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.	
<i>Professional Skepticism</i>	12. In accordance with SA 200 (Revised) , the auditor shall maintain an attitude of professional skepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance. (Ref: Para. A7- A8)	A7. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Maintaining an attitude of professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor’s attitude of professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

Context	Requirement	Application
		A8. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's attitude of professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.
<i>Risk Assessment Procedures and Related Activities - Management and Others within the Entity</i>	18. The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.	A17. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.
<i>Responses to the Assessed Risks of Material Misstatement Due to Fraud - Overall Responses</i>	28. In accordance with SA 330, the auditor shall determine overall responses, to address the assessed risks of material misstatement due to fraud at the financial statement level.	A33. Determining overall responses to address the assessed risks of material misstatement due to fraud, generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism, for example, through: <ul style="list-style-type: none"> <li>• Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.</li> <li>• Increased recognition of the need to corroborate management explanations or representations concerning material matters.</li> </ul>
<b>SA 250: Consideration Of Laws And Regulations In An Audit Of Financial Statements</b>		
<i>Responsibility of the Auditor</i>	8. The auditor is required by this SA to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements, may bring instances of identified or suspected non-compliance to the auditor's attention. Maintaining an attitude of professional skepticism throughout the audit, as required by SA 200 (Revised), is important in this context, given the extent of laws and regulations that affect the entity.	
<b>SA 330: The Auditor's Responses To Assessed Risks</b>		
<i>Overall Responses</i>	5. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.	A1. Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

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		<ul style="list-style-type: none"> <li>• Emphasising to the audit team the need to maintain professional skepticism.</li> </ul>
<b>SA 540: Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures</b>		
<i>Risk Assessment Procedures and Related Activities</i>	<p>9. The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor’s review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.</p>	<p>A40. The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor’s professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.</p>
<b>SA 550: Related Parties</b>		
<i>Responsibilities of the Auditor</i>	<p>7. Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.</p>	
<i>Understanding the Entity’s Related Party Relationships and Transactions</i>	<p>12. The engagement team discussion that SA 315 and SA 240 require<sup>2</sup>, shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity’s related party relationships and transactions.</p>	<p>A9. Matters that may be addressed in the discussion among the engagement team include:</p> <ul style="list-style-type: none"> <li>• The nature and extent of the entity’s relationships and transactions with related parties (using, for example, the auditor’s record of identified related parties updated after each audit).</li> <li>• An emphasis on the importance of maintaining an attitude of professional skepticism throughout the audit, regarding the potential for material misstatement associated with related party relationships and transactions.</li> </ul>

<sup>2</sup> SA 315, paragraph 10; and SA 240 (Revised), paragraph 15.