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Importance of scepticism in practice

20. Over the years, disciplinary investigations into Equitable Life Assurance Society, London International Group, Independent Insurance, TransTec, Wickes and ERF Holdings have identified audit failings. These include instances of over reliance on management representations, failure to investigate conflicting explanations and failure to obtain appropriate third party confirmations - which may suggest that the auditors in these cases were not sufficiently sceptical.
21. A lack of scepticism has also been reported by the AIU. One of the findings described in their 2009/10 Annual Report¹³ was that audit firms are not always applying sufficient professional scepticism in relation to key audit judgements. In particular, audit firms sometimes approach the audit of highly judgmental balances by seeking to obtain evidence that corroborates, rather than challenges, the judgments made by their clients.
22. The AIU also reported that auditors should exercise greater professional scepticism when reviewing management's judgements relating to fair values and the impairment of goodwill and other intangibles and future cash flows relevant to the consideration of going concern.
23. In the US, research has shown that the failure to demonstrate an appropriate level of scepticism was a deficiency found in 60% of the cases where the SEC brought fraud related actions against auditors¹⁴.
24. This is consistent with the findings of the US Panel on Audit Effectiveness. The Panel, which was set up by the Securities and Exchange Commission (SEC) in 1998, conducted a very thorough review of the effectiveness of large audits by the large audit firms¹⁵. The Panel reasserted the importance of professional scepticism and observed that:
- auditing standards needed to provide better guidance on how to implement the concept,
 - audit firms should more effectively teach the concept of professional scepticism, and
 - audit firms should develop or expand training for auditors at all levels oriented toward responsibilities and procedures for fraud detection. These programs should emphasise interviewing skills and the exercise of professional scepticism, as well as testing techniques.

¹³ Published on 21 July 2010

¹⁴ Beasley, M.S., J.V. Carcello & D.R. Hermanson, 2001. Top 10 audit deficiencies. Journal of Accountancy 191 (4):63-66

¹⁵ At the request of the SEC, the Public Oversight Board appointed the Panel on Audit Effectiveness in October 1998 to assess whether independent audits of the financial statements of public companies adequately serve and protect the interests of investors. The Panel reviewed and evaluated the way that audits were performed, and assessed trends in audit practices to determine whether they were in the public interest. It studied the audit policies, methodologies and other forms of guidance used primarily by the large audit firms, certain aspects of auditor independence and the auditing profession's self-regulatory structure.

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