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Toward a Conceptual Framework of Professional Skepticism in Auditing

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ABSTRACT

There have been an increasing number of arguments on a national and an international level, both academically and practically, on "professional skepticism in auditing." The internal and external environments surrounding independent auditors have resulted in an eroding of professional skepticism and have threatened to weaken society's trust in auditors. Professional standards have long emphasized an appropriate degree of skepticism in the entirety of the evidence process, which is composed of planning audit programs, performing audit procedures, and evaluating the audit evidence. Auditors are expected to understand that the essence of skepticism is "raising a question" and "exhibiting a questioning mind," yet this is not enough to prevent audit failures resulting from insufficient skepticism.

Professional skepticism in auditing is a *hybrid* concept constituting the epistemic *and* psychological aspects of cognition. The former is related to a way of knowing and fundamentally deals with what approach (positive or negative) the auditor should adopt prior to designing the evidence process. The latter is related to the auditor's disposition to raise a question in a particular audit setting and fundamentally deals with measuring the depth and breath of the auditor's questioning mind.

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Research on professional skepticism has been in progress for some time, yet appears to have been inclined toward the second aspect and to have almost overlooked the first aspect. To address the first aspect, this paper presents a conceptual framework of professional skepticism which can contribute to improving audit quality.

Key words
Professional skepticism, confirmation, falsification, audit postulates, presumptive doubt, audit risk approach, statement audit, forensic skepticism

Toward a Conceptual Framework of Professional Skepticism in Auditing

I. Introduction

Increasing professional skepticism on the part of auditors is a highly urgent theme to which the worldwide accounting profession is now paying significant attention. It has been repeatedly emphasized in numerous venues such as the European Union [EC 2010], the Auditing Practices Board [2010 and 2011], the Financial Services Authority and the Financial Reporting Council [2010], the American Institute of Certified Public Accountants (AICPA [2010]) and, most recently, the International Auditing and Assurance Standards Board [2011]. For instance, the AICPA response to the European Commission Green Paper (EC [2010]), emphasizes that professional skepticism is a critical skill and that research should be undertaken to assess how professional skepticism is implemented and "to explore the behavioral elements that may compromise professional skepticism, for example, auditor behavior which is influenced by individual biases and paradigms"([2010], 2). More recently, the chairman of the PCAOB has asserted that the foundation of a public accounting audit is "independence" and "professional skepticism" (Doty [2011]).

More fundamentally, professional skepticism needs to be rooted in honesty and trust. It does not imply a philosophy of either dishonesty or distrust (Burton [1980]). When an auditor perceives dishonesty and ceases to trust management, it is fundamental that the auditor withdraw from the engagement. President Reagan's famous words on the occasion of arms negotiations with the Soviets, "Trust, but verify," apply, just as well to professional skepticism in auditing (Grumet [2003]).

The question "How should we increase the quality of the financial statement

audit?"(Peecher et al. [2011]) is related to inward skepticism (Bell et al. [2005]), one possible form of professional skepticism in which auditors question the appropriateness of their own judgments as well as the effectiveness of the process through which these judgments are made.

Although the importance of professional skepticism has been emphasized in different ways, the common underpinning is "How can auditors exercise the right degree of professional skepticism?" Improving professional skepticism is not easy, however, because the degree of skepticism to be exercised is positively or negatively influenced by a variety of factors.

In addition, the "audit culture" (Doty [2011]) and "audit firm culture" may weaken professional skepticism. For example, a longer tenure may make the auditor less challenged, less skeptical, or compromised (Deis and Giroux [1992]; Shaub and Lawrence [2002]; Carcello and Nagy [2004]; Bedard and Johnstone [2010]). The SEC's requirement of engagement partner rotation reflects the danger from an auditor's loss of healthy skepticism. In this sense, a mandatory rotation of accounting firms (as auditors), which would lead to a change in the audit culture, might influence the degree of professional skepticism applied. Assuming that this audit culture will not change in the short term, however, it is necessary to improve the auditors' mindset toward professional skepticism. This, simply put, is the issue in professional skepticism with which the accounting profession is faced.

Hurtt ([2010],150], an influential researcher inthis field, understands professional skepticism as "a multi-dimensional individual characteristic." This view is in line with the her prior research (Hurtt [1999]; Hurtt et al. [2008]) viewing it as an individual trait rather than as a response to audit circumstances. To be sure, judgments are indebted to individual auditors' personal traits. However, this view oversimplifies the complicated compound nature of the auditor's professional skepticism. Although Hurtt appears to have narrowed her view from that in her previous research, she states frankly the problem facing research on professional skepticism:

Because of the lack of clear understanding about what constitutes professional skepticism, it can be difficult to compare or draw conclusions among accounting research studies that address professional skepticism. (Hurtt [2010], 150)

Almost all previous research on (or related to) professional skepticism, Hurtt not excepted, has been inclined toward the psychological/behavioral aspect of professional skepticism (Shaub [1996], [2004]; Choo and Tan [2000]; Quadackers [2007]; Nelson [2009]) and has overlooked its epistemic aspect. Researchers may have taken for granted

that the auditor's epistemic activities are basically "confirmation," although some empirical studies already suggested that "confirmatory behavior may not prevail or dominate in the audit judgment process"(McMillan and White [1993], 463), and also that such epistemic activities must not be "falsification" at all in a philosophical sense. But, any discussion on professional skepticism needs to start without any preconceived ideas.

II. A Historical Sketch of Skepticism in Auditing

How has the concept of skepticism in auditing been recognized? In this section, its conceptual development is explained chronologically, before further analysis is added.

The largest problem currently facing researchers is the lack of a commonly accepted definition of "skepticism in auditing"(Bell et al. [2005]; Nelson [2009]; Quadackers [2009]; Hurtt [2010]). The most commonly cited definition focuses on the psychological aspect of audit cognition, that is "the auditor's questioning mind." This definition only emphasizes that the auditor should have a questioning mind when evaluating the evidence and does not see skepticism as a way of knowing.

Origin in the 1950s

In its release on the McKesson & Robbins case of 1938, the Securities and Exchange Commission (SEC) asked auditors to "go into an audit with a copious amount of skepticism"(AICPA [1988e], 84). This case release may be the beginning of the emphasis on "professional skepticism."

An extensive survey of the accounting and auditing literature indicates that "skepticism" initially referred to its ordinary meaning, not to a concept[1]. The author believes that it first appeared as "an attitude of healthy skepticism" in a paper entitled "Professional Standards" (Wilcox [1952], 12). Wilcox used the term to amplify the "professional due care" to be paid by an independent auditor. He understood professional skepticism as the attitude an auditor should have when handling evidence and considered it a healthy attitude.

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[1] The author conducted an extensive survey to know how "skepticism" or "professional skepticism" has been used by searching the words in the electronically converted full texts of the accounting/auditing journals (*The Accounting Review; Accounting, Society, and Organization; Accounting Horizon; Journal of Accountancy; Auditing: A Journal of Practice & Theory; and The CPA Journal*).

Developments in the 1960s

The organization which has continuously stressed the importance of professional skepticism with a warning is the SEC. Cohen ([1966], 58), a past Chairman of the SEC, expressed his concern about the profession's understanding of professional skepticism.

We wonder whether auditors sometimes forget that a basic qualification of their calling is that they have a healthy skepticism and look at the business operation as a whole rather than as a series of isolated technical questions.

The Philosophy of Auditing (Mautz and Sharaf [1961]), which is ranked (by the author) as *the* established classic of audit literature and which continues to influence audit thinking, introduced the concept as one of the ways of obtaining human knowledge:

> Skepticism. To these five positive methods (authoritarianism, mysticism, rationalism, empiricism and pragmatism: parenthesis added) of obtaining evidence in support of ideas and beliefs, Montague adds a sixth and negative method, that of skepticism. The value of this way of knowing is at once apparent to an auditor. (96)

Later, Mautz [1967] amplified skepticism as follows:

> In addition to the five positive ways of knowing, there is a sixth and "negative" method of particular importance to auditors. This is the method of skepticism. To be skeptical does not mean to be impossible to convince. *Rather it suggests an attitude toward evidence best described as rational evaluation.* (63, emphasis added)

Unfortunately, in his subsequent writings, Mautz did not go beyond introducing skepticism. Auditing scholars as a whole at that time did not deeply explore skepticism in auditing. In spite of Mautz' insight, the subject has not so far been approached philosophically.

Developments in the 1970s

Audit failures in the early 1970s showed the regulatory agency (SEC) that merely emphasizing the importance of professional due care was not enough and marked the beginning of increased SEC activity. In its Accounting Series Releases (ASR) #153 [1974] the SEC first recognized that audit failures were in part due to a lack of professional skepticism:

> Such information indicated that Touche failed to obtain sufficient independent evidentiary material to support its professional opinion in regard to a number of highly material transactions which were constructed by management in such a way as to make it appear that income had been earned when in fact it had not been. In connection with these transactions it also appeared that Touche failed to fully

appraise the significance of information known to it and to extend sufficiently its auditing procedures under conditions which called for great *professional skepticism* (emphasis added).

ASR #153 further emphasized that the skepticism of an auditor should always be healthy. Since ASR #153, when judging the quality of auditing procedures or considering the cause of a failure, the SEC has continued to apply the "professional skepticism" perspective and has strengthened its professional skepticism stance.

It is not clear when the American Institute of Certified Public Accountants (AICPA) first recognized the importance of professional skepticism. From the literature survey, it appears that the Commission on Auditors' Responsibilities (the Cohen Commission: [1977[2]]), an independent commission of the AICPA, first officially recognized the concept. SAS No.16 refers to the term only to emphasize that "the auditor should plan and perform with an attitude of professional skepticism"(par. 6). The Cohen Commission Report ([1978], 38) emphasized that:

> The exercise of professional skill and care requires healthy skepticism—a disposition to question and test the validity of all material management representations. The independent auditor should approach an examination with an open mind about the integrity and good faith of management. He should neither assume that management is dishonest nor take management's integrity and good faith for granted. The auditor's tests of the validity of transactions and resulting financial statement amounts or other evidence may cause him to question management's honesty or good faith.

In spite of these insights by the Cohen Commission Report, the concept of "professional skepticism" was not immediately reflected in the subsequent revision of Statements on Auditing Standards. To most accountants at that time, professional skepticism was no more than one of the tools for defensive auditing (Chazen and Solomon [1975]).

A Statement of Basic Auditing Concepts (ASOBAC [1973]) recognized the problem of observational errors in the investigative process. ASOBAC identified four causes of observer errors: (1) a lack of observational ability (knowledge/skills), (2) a lack of objectivity (a possible bias held by the auditor), (3) destruction of the environment by the observer, and (4) the problem of indirect audit evidence. ASOBAC (30) briefly explained

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[2] The Cohen Commission recognized the concept of professional skepticism in its tentative report ([1977], 38).

(1) as follows:

> We observe only what we know how to observe. What we accomplish by education, experience, imagination, and skepticism is to see *more than* meets the eye (emphasis added).

"See *more than* meets the eye" means bringing one's questioning mind into full play to identify whether any false statements, contradictions, or irregularities are hidden in the financial statements, accounting books, and records. In other words, the auditor does a "smell test" to find a clue to any inconsistency or irregularity among the audit evidence

Anderson ([1977], 125), influenced by ASOBAC, identified (1) the competence of the observer, (2) observational bias, and (3) a lack of professional due care as factors that cause errors in observations and which may affect even professional auditors. He further identified three factors that may cause a mistaken observation: "indirect audit evidence," "destruction of audit evidence by the observer," and "the risk of not identifying suspicious situations," and then characterized all of them as ascribable more or less to a lack of "reasonable skepticism." It is not clear, however, how he interprets "reasonable skepticism."

From a professional skepticism perspective, the 1970s can be deemed a prelude to the revisions of Statements on Auditing standards of the next decade. Without stressing professional skepticism in the audit evidence process, particularly within the GAAS framework, the depth of auditing procedures as a whole cannot be attained.

Developments in the 1980s

The 1980s saw the conspicuous development of skepticism in auditing. Brown and Calderon [1993] pointed out, for example, the inverse relationship between the two general categories (lack of independence and lack of professional skepticism) causing audit failures which the SEC cited in the enforcements for the years 1980-1989: independence was cited less while skepticism was cited more. The SEC continued to express, at every opportunity, its anxiety that "auditors are not showing enough skepticism in carrying out audits" and that "they seem 'too eager to please their client"(AICPA [1985a], 34), and to stress that "independence and skepticism are factors in the exercise of judgment"(AICPA [1987]) and that "to provide adequate training for auditors and other accountants to develop inquisitive minds, sound analytical skills, skepticism and professional integrity"(AICPA [1988]).

In response to repeated audit failures (*e.g.* United States vs. Arthur Young [1984]) due to inappropriate audit judgments, the accounting profession (AICPA) issued Statement on Auditing Standards (SAS) No. 53 [1988], which included the first official

statement on professional skepticism under the so called "Expectation Gap Project"(Guy and Sullivan [1988]). SAS No.53 tied professional skepticism exclusively to audit planning and performance, but without a clear definition of the term. It characterized skepticism first as *neutral* in that the auditor should neither trust nor distrust managements, and second as *prescriptive* in that it was referred to in relation to Generally Accepted Auditing Standards. As far as professional standards are concerned, skepticism at this stage seemed to be simply associated with the field work. A heightened degree of professional skepticism was stressed, particularly in the face of the increased risk of related-party transactions or material misstatements (Wiesen and Carmichael [1983]).

Developments in the 1990s

In response to increasing SEC concerns and public criticism of the profession, in 1992, the Public Oversight Board of the AICPA established the Panel on Audit Effectiveness (Shaun F. O'Malley, Chairman), consisting of eight members, in response to a request from the Chairman of the SEC (Arthur Levitt) to examine the effectiveness of the existing audit model. It took more than seven years, however, for the Panel to finalize its study.

In 1993, the Public Oversight Board of the AICPA issued a special report which (1) stated that auditors were not sufficiently sensitive to the degree of professional skepticism required by auditing standards and (2) asked accounting firms to assure more consistent implementation of professional skepticism (POB [1993]).

In 1997, the AICPA issued SAS No. 82, which modified the discussion of skepticism in SAS No.53. In a further development, SAS No.82 viewed professional skepticism as the key quality of professional due care and referred to it in relation to the "general standards" rather than "the standards of field work." In addition, professional skepticism was featured as *substantive* in nature in that it represented the substance of professional due care the auditor should exercise.

SAS No.82 began to catch fire in audit scholars' minds in such a psychological way as to raise the question "What factors influence the auditor's questioning mind (professional skepticism)?" In response to this question, Kennedy ([1995], 9) suggested that "some mechanisms of debiasing the curse of knowledge are potentially conducive to professional skepticism."

SAS No.82 also prompted practicing auditors to pay more attention to the effect of a skeptical attitude in ferreting out misstatements. For example, it emphasized that the auditors must "follow up any potentially material negative indicators to determine whether or not financial statements are free from material misstatement" (Groveman

[1995], 83). In other words, to audit practitioners, professional skepticism meant that they must take nothing for granted and "must be more sensitive to the possible existence of fraud and watch out for uncorroborated responses to inquiries" (Barnett et al. [1998]).

Developments in the 2000s

On August 31, 2000, the Panel at length published its report, *The Panel on Audit Effectiveness Report and Recommendations.* The Panel, distinguishing a financial statement audit under GAAS from a "fraud audit" or a "forensic audit"(76), gave insight into professional skepticism in reference to a "forensic-type fieldwork phase" as follows (88):

> Not unlike the traditional planning, interim, final, and review phases of audits, this new forensic-type phase should become an integral part of the audit, with careful thought given to how and when it is to be carried out. A forensic-type fieldwork phase does not mean converting a GAAS audit to a fraud audit. Rather, the characterization of this phase of a GAAS audit as a forensic-type phase seeks to convey an attitudinal shift in the auditor's degree of skepticism.

"A forensic-type fieldwork phase" may imply that auditors should replace their current neutral view of professional skepticism with a presumption of the possibility of intentional/material misstatements and should use "'retrospective auditing procedures' in which they would assess how various issues involving accounting estimates and judgments in previously issued financial statements were resolved" (Carpenter and Mahoney [2000], 22).

The Panel observed that the risk assessment called for by SAS No.82 is not sufficient in that it fails to direct auditing procedures specifically toward fraud detection and so does not significantly increase the likelihood that the auditor will uncover material fraud ([2000], 86). In addition, the Panel pointed out (86) that generally accepted auditing standards does not provide adequate guidance for implementing the concept of professional skepticism.

Accounting scandals at the beginning of the 21st century reinforced the need for professional skepticism. Beasley et al. [2001] found that a lack of professional skepticism was the single most-often-cited cause for the SEC's actions against auditors. In 2002, the AICPA issued SAS No. 99, also entitled *Consideration of Fraud in a Financial Statement Audit*. This standard, which supersedes SAS No. 82, expands the discussion of professional skepticism, emphasizing the auditor's responsibility to explicitly or proactively consider the possibility of fraud in every engagement. SAS No.99 (AICPA [2002] par.10?) stresses that auditors must maintain their professional skepticism

"regardless of any past experience with the entity and regardless of the auditor's beliefs about management honesty and integrity." Such professional skepticism requires that "the auditor should not be satisfied with less than persuasive evidence" (Victor and Levitin [2004], 27).

Ramos [2003] evaluated the significance of SAS No. 99 as follows: "It is a standard that reaches into all areas of the audit process and it moves auditors in a different direction, away from the 'checklist mentality' and more into a thinking person's audit (that is, a professional-skepticism-oriented audit)"(36; parentheses added). The perception that using a checklist may hinder the auditor's professional skepticism has also been made (IAAS [2011], 72.).

SAS No.99 again raised the question "What factors influence the auditor's questioning mind (professional skepticism)?" Empirical research began to target the question exclusively. Hurtt ([2010], 99), who perhaps pioneered research on the subject, empirically identified auditors' personal characteristics as influential factors.

The PCAOB [2008] criticized, through the summary report on its annual inspections, the insufficiency of professional skepticism particularly in areas that involved management's most complex judgments. Accordingly, the PCAOB as well as the SEC is expected to focus heavily on indicators of lack of professional skepticism during its inspection process.

III. Why is skepticism difficult to deal with in auditing?

Regardless of its utmost importance, strictly speaking, not until the issuance of SAS No.82 [1997] did practicing accountants and audit scholars begin to pay explicit attention to the concept of professional skepticism. Until then, recognition of its importance was confined to a few academics and some accounting professionals. In addition, the meaning of the term "professional skepticism," as seen in prior professional and academic audit literature varies (AICPA SAS No.xx; Choo and Tan [2000]; Cushing [2000]; Panel [2000]; Hurtt [2010]; Bell et al. [2005]; Nelson [2009]). Three issues help to explain why professional skepticism in auditing is hard to deal with.

Fear of increase in professional responsibility

It is not clear why professional skepticism took so long to be officially recognized in Statements on Auditing Standards (SASs). The accounting profession (as represented by the AICPA) might simply have had second thoughts about professional skepticism for almost the same reason it took so long to address "fraud." The AICPA might have perceived the possibility that any explicit reference to "professional skepticism" and

"fraud" in official statements would result in an increase of professional responsibility under the so called statement audit. It is quite understandable that the accounting profession was concerned about such an increase, and therefore was not always receptive to any revision of professional standards that would increase its members' responsibility and liability. Carmichael and Craig [1996] give some support to the above observation.

Increasing complexity in the external auditing environment

The profession's unreceptive attitude to explicit reference to professional skepticism in the professional standards may also be related more to the intrinsic nature of auditing (conducting an audit) which includes, intrinsically, the act of *questioning* statements by another individual or the conduct of another individual. Even without emphasizing the element of "skepticism," the auditor must raise questions or doubts during the evidence process. An auditor who lacks skepticism or a questioning mind is disqualified from conducting an audit.

Why do we need to bring skepticism into academic focus, then? First, the auditor is generally stuck with organizational, economic, and environmental factors that may hinder his/her ability to exercise professional skepticism. Even though the auditor is prudent, skeptical, and competent if he/she fails to appropriately exercise professional skepticism during the evidence process, the result may be an audit failure with a disastrous effect on the financial community. Second, schemes for fraudulent financial reporting can become so extremely complex and ingenious. In some cases (for example the Lincoln Savings and Loan case in 1987 and the Enron case in 2001), which underscore the importance of professional skepticism in evaluating financial statements, the complexity and skillfulness of the fraudulent scheme might have overwhelmed the professional due care, including professional skepticism, exercised by the auditor (Benston and Hartgraves [2002]).

Even for professional auditors, some new areas may be difficult to handle, including digital documents and enormous amounts of digitized transactions (Nearon [2005]; Caster and Verardo [2007]), high-tech products or complex financial instruments (Groveman [1995]), fair value accounting with estimates heavily involved (AICPA SAS No.101; Martin et al. [2006]), and earning management(Akers et al. [2007]; Jackson and Pitman [2001]; Anderson et al. [2004]). These emerging areas should have increased the demand for auditors to sharpen their professional skepticism during the whole process of evidence.

The evidential positiveness under which auditors behave

Management is responsible for preparing financial statements (1) by selecting and

applying generally accepted accounting principles (GAAPs) as deemed reasonable in the circumstances, (2) by maintaining reliable accounting books and records underlying the financial statements, and (3) by maintaining an effective system of internal accounting controls within the company in an atmosphere in which its corporate governance works effectively. Management is expected to be interested in a fair presentation of financial statements within the framework of GAAP. Because statements exist before auditing starts, the auditor presupposes that the statements fairly present the company's economic affairs. This means that the auditor accepts the financial statements at face value and examines them with cooperation from the management.

In reality, however, no matter how much care has been taken by management, the statements may include material misstatements that can affect economic decisions. Or, management may intentionally prepare fraudulent financial statements in order to cover up a worsened financial position and the results of operations. In other words, any financial statements may include material misstatements (a financial statement risk), regardless of the cause. No financial statements are free from such a risk. Auditors are surrounded by the "positive supporting information" furnished by management, which has an incentive to present the statements which are with as much positiveness as possible, and the auditor must struggle against such positiveness in order not to be overwhelmed by it.

The hidden problem for most auditors is that they have not experienced material management fraud (intentional material misstatements) first-hand and may be overconfident in presuming its absence, swallowing management's story hook, line, and sinker, as often seen in audit failures. A heightened professional skepticism should lead auditors to challenge evidence that doesn't make sense and to obtain additional corroboration of management's explanations or representations.

Any consideration of professional skepticism in auditing needs to begin with a deep knowledge of the inherent constraints imposed by the statement audit. The very nature of a statement audit can weaken the ability to exercise professional skepticism and, in some cases, actually inhibit it. This phenomenon is referred to here as "a trap embedded in the auditor's cognition under a statement audit." Management asserts the financial statements to be appropriately prepared in conformity with GAAP, even if they are not. Ideally, all information which management provides for the auditor should be "supportive," but along with the tremendous quantity of supportive information, the auditor may receive a limited amount of information suppressing real events. The auditor has a professional responsibility to uncover material misstatements (negative information)

that have been included, either intentionally or mistakenly.

The chief aim of this research is to establish a methodology for obtaining such audit cognition and to develop a possible framework which enables an auditor to break free, as much as possible, from the cognitive trap of professional skepticism existing intrinsically in the statement audit. The result of a more careful/effective cognition will be a higher-quality audit.

Six factors—auditors' personal traits; the contractual, economic, and organizational aspects of the accounting firm; and environmental and internal factors of the client—all influence the depth of professional skepticism that should be exercised in a particular setting. These six factors do not necessarily act separately, but have a mutually potentiating/compound effect. A lack of professional skepticism may be triggered simply by an error of judgment in previous audit settings; however, it will usually bebrought about by the compound effects of factors which weaken or fog the auditor's attitude toward raising a question or a doubt. But is a lack of professional skepticism ascribable only to these six factors? The author thinks that the "way of knowing" that the accounting profession presupposes can also limit or weaken the professional skepticism auditors need to exercise.

IV. General Arguments related to Skepticism in Auditing

There are two main streams of thought regarding skepticism in philosophy: epistemological or systematic skepticism and methodological or inquisitive skepticism. Epistemological (systematic) skepticism denies the possibility of any knowledge, "global or local"(O'Brien [2006]; Popkin and Maia Neto [2007]), "strong or weak" (Malcolm [1963]), and therefore does not contribute to problem-solving activities (Bunge [1991]; Kurtz [1992]). On the other hand, methodological (inquisitive) skepticism is constructive in that it is intended to solve problems in actual life, and has been strongly advocated by the philosopher Kurtz [1992].

From the philosophical point of view, skepticism in auditing should not take an epistemological (systematic) form dealing with "Can we obtain (real) knowledge?" Rather, it should be *inquisitive* or *methodological* skepticism (Hurtt [1999]; Quadackers [2009]), which contributes to the formation of the auditor's "reasonable and justified belief" as to the statement concerned. It should be separated from "forensic" skepticism, which focuses only on the detection of particular human acts.

Professional Skepticism as a Hybrid Concept

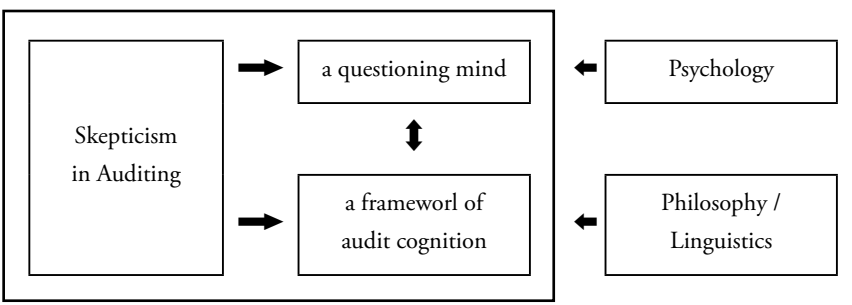
Previous discussions of professional skepticism have generally emphasized that

auditors should assume the honesty and integrity of the management and then associate that assumption with the definition of professional skepticism as to the state of an auditor's questioning mind. However, SAS 99 (the source of AU316) recognizes that the auditor should instead focus on uncovering material misstatements, particularly those resulting from fraud and requires auditors to approach their task with a healthy skepticism. To respond to this current development, skepticism needs to be redefined.

In auditing, skepticism is a hybrid concept comprising the following two dissimilar areas (see Figure 1):

1) how the auditor forms a reasonable and justified belief regarding the financial statements. This area is fundamentally related to a way of knowing in philosophy.
2) identifying factors that influence the auditor's questioning mind and measure the depth of professional skepticism in terms of these factors. These activities assume the way of knowing and are related, in psychology, to a way of making judgments and decisions.

Figure 1 The Hybrid Nature of Skepticism in Auditing



Since a financial statement audit is conducted in an institutional environment, research is unavoidably subject to institutional constraints, for example those imposed by GAAS. Apart from such institutional factors, however, it is necessary to consider fundamentally what a conceptual framework of professional skepticism will look like. The results might give new insights into the existing arguments on verification and might also influence the mindset of auditors in a financial statement audit.

V. A Framework for Professional Skepticism in Auditing

As mentioned earlier, the concept of skepticism has not been consistently defined

and the different perspectives in the literature have led to different definitions (Nelson [2009]). In auditing, skepticism is a hybrid concept which is composed of (1) a way of knowing which the auditor will follow and (2) the auditor's questioning state of mind.

Figure 2 shows an overall framework which contains four cells, each cell representing an auditor's epistemic mode where the hybrid nature of professional skepticism is incorporated as two epistemic axes. Each cell (each epistemic mode) shows, in general, how deeply the auditor will be able to exercise professional skepticism in the evidence process. In the next sections, each axis is explained.

Figure2 A Framework of Skepticism in Auditing

		Ways of knowing	
		Positive approach (substantiation)	Negative approach (falsification)
A questioning mind	Neutrality	**I**	**II**
	Presumptive doubt	**III**	**IV**

1. The First Epistemic Axis: A Way of Knowing

A clear and elementary introduction to the philosophy of science (Chalmers [1999]; Salmon [1967]) explains two different ways of knowing, both of which essentially belong to the *induction* method, basing a general conclusion on observed evidence. These two ways of knowing are *confirmation* and *falsification*—refutation by counter example (Quine and Ullian [1970]; Salmon [1967]).

An auditor's epistemic activity is far from precise in comparison with that of a scientist, in that the auditor not only deals with many kinds of human phenomena and social norms, but also must rigidly complete his task under a particular time constraint. What scientists and auditors have in common, however, is that their arguments and inferences are equally based on evidence (observed instances, observed facts, observed samples, etc): both stand on the same epistemic ground. Borrowing underlying thoughts and/or methodologies from the philosophy of science and logic will deepen the epistemic analysis of the auditor's cognition in terms of professional skepticism.

The affirmative approach: Confirmation

Professional skepticism is related to "how an auditor can verify the proposition." One approach is to collect competent and sufficient evidence to substantiate the assertions in the financial statements. An assertion reflects management's perspectives and therefore is always positive or affirmative. It is confirmed by each piece of evidence which lends positive support. Of course, one positive piece of evidence does not clinch the assertion, but each piece adds to its plausibility (Quine and Ullian [1970], 67-68). The more positive evidence the auditor can collect, the more strongly is the assertion confirmed.

This affirmative approach (here called substantiation), is inductive. *Induction* is the familiar method of verifying (substantiating) a general assertion from relevant facts, observed instances, or positive evidence. Substantiation is based on the idea that the strength of the evidence verifying the proposition increases as each piece of such evidence is accumulated. Thus, auditors conventionally substantiate a particular assertion by increasing the amount of positive evidence. The more pieces of positive evidence, the higher the probability of the conclusion. The positive instances (evidence) accumulated from various sources eventually constitute confirming evidence for the assertion.

Historically, Bacon (1561-1626), a British empiricist who sharply criticized the abstract theorizing of the medieval age, made the initial reference to the inductive method as the path to knowledge (Woodhouse [2006]). He got to the heart of our epistemic problem by recognizing the human proneness to favor positives (affirmatives) as follows ([1620/1960], 51):

> "XLVI
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> It is the peculiar and perpetual error of the human intellect to be more moved and excited by affirmatives than by negatives; whereas it ought properly to hold itself indifferently disposed toward both alike. Indeed, in the establishment of any true axiom, the negative instance is the more forcible of the two."

Although induction has been widely accepted, it involves a human (psychological) problem in that "when trying to collect information, people tend to seek out information that would potentially confirm the belief over information that might disconfirm it."(Gilovich 1991, 33). The academic auditing literature (Waller and Felix [1984], Church [1990], Guiral et al. [2011]) suggests that auditors are likely to exhibit a confirmation-prone attitude toward evidence and, more importantly, that confirmation proneness is likely to erode professional skepticism and impair audit effectiveness. Bamber et al. ([1997], 250) go so far as to state definitely that "the presence of a confirmation

prone attitude in auditors would appear to be in conflict with professional standards."

The substantiation (confirmation) approach to verification in auditing presupposes that "[t]here is no necessary conflict of interest between the auditor and the management of the enterprise under audit"(Mautz and Sharaf [1961], 42). This postulate (referred to here as "the Mautz postulate") implies that both the management and the auditors are *interested in the same result*, that is, the fair presentation of the financial statements (Mautz [1958], 41). According to the Mautz postulate, management is responsible for a presentation that reflects the nature and operations of the company in conformity with a financial reporting framework, for example U.S. GAAP or IFRS. In the financial statements, management explicitly or implicitly makes assertions regarding the recognition, measurement, and presentation of information (including related disclosures). Auditors collect evidence to verify these assertions.

The auditor's cognition is basically aimed at ascertaining evidence for a particular assertion, not evidence that negates it. This affirmative approach, combined with the positiveness furnished by management, erodes or compromises the auditor's skepticism during the evidence process and explains in part why in the past auditors have often made do with the evidence which management supplied. It implies that skepticism in auditing contains *a structural* facet as well as a functional one. The affirmative approach has continued so far as the prevailing GAAS audit practice.

The negative approach: Falsification

If the auditor confines himself/herself to substantiation (confirmation) exclusively, he/she is likely to exhibit proneness for confirming evidence and a tendency to ignore negative instances or signals. Another possible approach to verification is the negative approach (falsification) or the counter-evidencing approach. Popper [1968] advocated falsification as the most powerful alternative to confirmation.

The faslification approach emphasizes the strength of negative evidence rather than positive (affirmative) evidence in the verification process. In other words, the negative approach stresses that negation is more powerful than affirmation and maximizes the value of a single piece of negative evidence. Quine and Ullian ([1970], 67-68) explain the asymmetry between affirmation and negation as follows:

> A lawlike generalization, then, is confirmed by each of its instances. An instancedoes not of course clinch the generalization, but each instance adds to the plausibility of it. A generalization with even a single false instance, on the other hand, is irremediably false. Any hypothesis, indeed any statement at all, that implies a falsehood is itself false. This *asymmetry* is pure logic: what implies a truth may be

true or false, but what implies a falsehood is false. (emphasis added)

The negative approach (falsification), unlike the positive approach (substantiation), presupposes that "there always *exists a potential conflict of interest* between the auditors and the management of the enterprise under audit" (Robertson [1979], 31; referred to here as "the Robertson postulate," emphasis added). In this approach, the auditor proactively designs the procedures to search for material misstatements which may result from error, fraud, and even illegal acts (SAS No.54). Auditors appear to have begun to realize the significance of holding this view, although many might still prefer to believe the Mautz postulate.

The negative approach to verification emphasizes that a proposition can be denied by a single piece of sufficiently material negative evidence. The negative approach does not seek the level of positive proof which the auditor needs to form his/her opinion, although almost all auditing procedures, of course, serve a dual purpose. The negative approach by itself does not determine how negative evidence should be treated, but it encourages the auditor to proactively search for and/or focus on negative rather than positive evidence, starting right from *the audit planning stage*. As mentioned, SAS No. 56 (AICPA [1988]) emphasizes that auditors should apply analytical procedures in the planning stages of the evidence process to identify and investigate unusual fluctuations in financial statement relationships (symptoms indicating the possibility of material misstatements). The effectiveness of analytical procedures that heighten the auditor's skepticism has been empirically supported (*e.g.* Wright and Ashton [1989]).

Under this approach, a positive proposition is replaced by a proposition stated in the double negation form: proposition X is represented either as "not $\overline{X}$" or as "$\sim\overline{X}$."[3]

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[3] In a strict sense, the word "proposition" should be used instead of "assertion" because the latter reflects the management's perspective, and therefore is not appropriate under the negative approach.

"X" denotes a positive form of a statement. For example, proposition X implies that the amount of a particular account is fairly stated (= X is true). If it is not fairly stated, then X is denoted in a negative form ($\overline{X}$). According to formal argument, two statements (propositions) are said to be *equivalent in truth value*, when they are either both true or both false, the notion of which is expressed as " $\equiv$." When two statements are equivalent in truth value, they materially imply each other. This can be easily verified by a truth table. Two statements are logically equivalent when the statement of their equivalence is a

Concretely speaking, the principal/general proposition stating that "the financial statements present fairly the financial position, the results of operations, and the change of financial position of the company under audit" is regarded as equivalent to the proposition "the financial statements are *free from* any material *misstatements*." The subordinate/elementary proposition, for example, that "the amount and disclosures of the accounts receivable are fairly presented" can also be regarded as equivalent to the proposition that "the amount and disclosures of the accounts receivable are *free from* any material *misstatement*."[4]

The negative approach requires the auditor to proactively uncover any material misstatements (negative evidence) throughout the evidence process, starting at the *ex ante* stage (audit planning) and continuing in the *on-going* stage (performing audit tests) and the *ex post* stage (evaluating the evidence collected). Most of the audit resources will be consumed in uncovering evidence indicating "$\overline{X}$"or giving a hint of "$\overline{X}$." If the auditor obtains material negative evidence, he/she will conclude that the proposition does not hold true. Not detecting of any material misstatement, regardless of the auditor's efforts is, from an epistemic point of view, the same as substantiating management's assertion. To put it another way, detection of no negative evidence, any material misstatement, during the evidence process constitutes confirming evidence for the proposition stated in a double-negative form (=the positive proposition) and the auditor eventually accepts the principal proposition as true in an epistemic sense.

Under this approach, the auditor concentrates on searching for negative evidence (material misstatements) rather than positive evidence, counting on the dual purpose nature of audit procedures, and may be less susceptible to confirmation proneness. It is correctly pointed out that "further research is needed to determine under which circumstances confirmation proneness dominates, as opposed to a skeptical attitude toward evidence"(Guiral et al. [2011], 174).

The negative approach will tend to make audits more effective but less efficient for

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tautology. A statement form $X \equiv \sim\overline{X}$ (double negation) is proved as a tautology as shown by a truth table, where "~" stands for "not." That is, double negation is a positive.

[4] The expressions "are free from" and "material misstatements" appearing in the proposition correspond to "do not include" (negation) and "are not correctly stated" (not X), respectively. "Material misstatements" is the complement of "fair presentations." Thus, these two expressions constitute the double negation. A double negation is a positive (copi [1972], 280; Lee [2002], 285)

the auditor and more expensive for the client. Belief based on falsification is expected to be stronger than belief based on substantiation, as partially supported by Fukukawa and Mock [2010], but this approach might not be desirable in situations where lawsuits alleging misconduct by management have seldom occurred.

2. The Second Epistemic Axis: A Questioning State of Mind

The second axis is the auditor's attitude toward raising a question. There are two perspectives, a neutrality view and a presumptive-doubt view, depending on the extent of the auditor's questioning state of mind. The former is the traditional view and the view held by GAAS. In addition, it is the view which management expects the auditor to hold. The presumptive-doubt view is more recent and not yet institutionally supported. However, although there is strong opposition, as shown in the international venue (Auditing Practices Board [2010] and [2011]), the audit practice appears to be moving toward that view.

The neutrality view of professional skepticism

The neutrality view, later called the "neutral concept of professional skepticism" (Panel [2000], 76), is the attitude that the auditor should neither unquestionably assume management's honesty nor flatly deny it, but should rather maintain neutrality on that question. This view, which has symbolically been called "healthy skepticism" and "reasonable skepticism," was thepremise for empirical research on auditors' evidence evaluation (Haynes [1999]). It emphasizes that the auditor should not unquestionably assume that management is honest, but should hold an unbiased view of management's honesty (dishonesty). The neutrality view, however, becomes less tenable in actual audit practice.

Professional skepticism has so far been discussed in terms of the honesty or dishonesty of management, as it was introduced even in the Panel's [2000] report. It has been the conventional way of discussing skepticism so far and therefore, it is difficult to find discussions that do not have that perspective. SAS No.82 and subsequent professional standards have taken only that perspective. A financial statement audit based on a presumption of dishonesty is not an actual practice, and such a presumption of dishonesty would be contrary to the audit culture, which the accounting profession has adopted. So is it critical to consider that perspective when professional skepticism is discussed?

The presumptive doubt view of professional skepticism

Audit failures suggest that the approach based on neutrality has not been sufficient.

No matter how much professional skepticism the auditor exercised, management has been able to design very complex and skillful—and successful—schemes for fraudulent financial reporting. This fact indicates that the audit approach needs to shift from being "based on the neutrality view" to being "based on another view": the presumptive doubt view. Bell et al. [2005] and Nelson [2009] have contributed to the recognition of this new perspective of skepticism.

The presumptive doubt view stresses that the auditor take a proactive approach to audit evidence (in particular negative evidence), always keeping it in mind that management may have incentives to intentionally misstate amounts or disclosures. While such a skeptical attitude is essential in any audit setting, management may at times strongly oppose this audit orientation, as already pointed out by Nelson [2009].

Auditors cannot be held responsible for uncovering material misstatements caused by all types of fraud or illegal actions. Collusive frauds and other intricate schemes such as round-trip (circular) transactions are very difficult to uncover. Nor does this presumptive doubt orientation, mean that the GAAS audit should be restructured as forensic auditing. Emphasizing professional skepticism in the GAAS audit calls for the auditor no to exercise *skepticism* at the forensic level but to exercise constructive skepticism, to apply the audit risk approach more extensively, intensively, and more rigorously. Should auditors accept the fraud examiner's advice on professional skepticism?

When gathering evidence, fraud examiners and auditors need to trust their instincts and check out their suspicions. Professional skepticism is really an enhancement of the "sixth sense" (Wells [2003], 80).Auditors under the GAAS audit should not appeal to "these pros think" but should start to explicitly recognize a negative assertion first.

The audit risk approach was originally designed for auditors to effectively put their epistemic focus on uncovering material misstatements under economic constraints. This does not, however, allow auditors to make a blanket excuse that they have refrained from searching for fraud. Restructuring the framework of professional skepticism would increase the auditors' chance to search out and uncover symptoms of fraud and other irregularities, resulting in material misstatements in the financial statements.

VI. An Analysis of Each Framework Mode

The GAAS audit (a financial statement audit performed under generally accepted auditing standards) has evolved under the continuing oversight of regulatory agencies, incessant litigation against CPA firms, and the social distrust of the independent audit function, but it has outgrown its responsiveness to professional skepticism. Professional

skepticism has a structural facet that is hard to handle in that an audit engagement is based on the mutual trust between management and an independent auditor and their presumed mutual efforts to attain a fair presentation of the financial statements. The expression "healthy" skepticism tells how sick the skepticism issue is in theory as well as in practice.

Professional skepticism cannot be discussed only in terms of the auditor's questioning mind because the depth and breadth of an auditor's questioning mind is influenced by the way of knowing which the auditor adopts. The previous section suggests four framework modes (Cells I to IV) of skepticism in auditing, which reflect different levels of audit effectiveness and efficiency. Each mode is explained below.

Mode I: The Positive approach with the Neutrality view

Mode I designates a positive (affirmative) approach with a neutral view of professional skepticism, presupposing the Mautz postulate. The framework of traditional auditing procedures before the introduction of the audit risk approach appears to belong to Mode I. Management, as well as auditors, have favored this framework (the substantiation approach). Conversely, one might say that management is less favorably inclined to auditor skepticism. Behn et al. [1997]) provide empirical evidence of a significantly negative association between auditor skepticism and client satisfaction.

Historically, an accounts audit conducted under the Companies Act in the 19th century in England could be regarded as one falling into Mode I, but in a looser sense. This conclusion can be traced in the court decision addressed to the Kingston Cotton Mill Company (Dicksee [1902], 615).

> He [the auditor] is entitled to assume that they [the directors] are honest and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind, he is only bound to be reasonably cautious and careful.

But the neutrality view together with evidential positiveness might weaken or compromised the professional skepticism the auditor needs to exercise.

In a statement audit, the auditor is substantiating the amounts and disclosures in the financial statements. Generally Accepted Auditing Standards (in particular, SAS No.1 [1973] and its subsequent issues up toSAS No.39 [1981]) stipulated the general framework of substantiation called "substantive tests" in terms of "(a) tests of details of transactions and balances accounts" and "(b) analytical review of significant ratios and trends and resulting investigation of unusual fluctuations and questionable items" (SAS No.1 [1973], 320.70). "Normal audit procedures and other audit procedures as the

auditor deems necessary under given circumstances" appearing in the previous form of an independent auditor's report constituted the framework for audit procedures.

Risk-orientation was quite limited at this stage, regardless of the observation that "the risk-assessment orientation. . . has been present in the financial statement auditing for at least 100 years"(Bell, et al. [2005], 8). Relative risk, the magnitude of possibility that a particular item in the financial statements will be inappropriately presented in comparison to the possibility that other items will be inappropriately presented, was the sole concept explicitly associated with an audit. The auditor's risk consciousness was limited to that level. It was not extended either to an overall risk of financial statements or to other phases of audit risk.

The audit approach represented by Mode I came gradually but necessarily to undermine a reasonable basis for expressing an opinion on the financial statements. Schemes for fraudulent financial reporting became more skilful, more complex, and were often elaborated in collusion with third parties. These phenomena, starting to occur more often in the 1970s, outpacedthe depth of professional skepticism expected under Mode I. In other words, professional skepticism weakened or was compromised and as a result, audit risk increased. Consequently, the accounting profession started to slightly shift the traditional framework into one that was more risk conscious. Accounting professionals were taking an increasing interest in detecting "material misstatements" while still preserving the substantiation approach.

Mode II: The Negative approach with the Neutrality view

The traditional substantiation approach, represented by Mode I, was not considered effective enough in lessening audit risk. The so-called "audit risk approach," introduced by SAS No.39 [1981], was designed to use audit resources effectively and efficiently to uncover material misstatements based on the assessment of business risk associated with the industry and operations of the client, the control risk of the client, and the inherent risk of accounts and disclosures prepared by the client. The audit risk approach prompted auditors to become more conscious of uncovering material misstatements, shifting the skepticism framework from Mode I to Mode II. At the initial stage, the auditor establishes "a degree of professional skepticism that is proper to achieve reasonable assurance that material errors or irregularities will be detected" (Wallace [1991], 19) and then brings the initial degree of skepticism into planning and performing the audit.

The present GAAS audit appears to belong to Mode II. Under the skeptical framework as shown in Mode II, auditors basically stay with substantiation while becoming more sensitive to the client risk (internal and external) and making negative

assertions depending on the client risk assessment. Under Mode II, auditors are encouraged to exercise a higher degree of professional skepticism in order to recognize fraud symptoms and then to follow up when they encounter a red flag. Their professional skepticism is confined to this level. The key is whether the auditor has explicitly recognized a negative assertion (proposition) in a particular setting, adapted to whatever the heightened client risk may be. Behaviors such as "searching for more persuasive evidence," "suspension of judgment," and "search for knowledge" (Hurtt [2010], 153-154) reflect the auditor's more skeptical behaviors (though such behaviors are also conceivable under Mode I.)

The audit risk approach is a strategic signal that the GAAS audit has changed its basic framework. At the same time, this approach does not increase its effectiveness when it is applied under Mode II because an *explicit* recognition of negative assertions (in other words, an orientation toward negative evidence) is allowed under SAS No.53 only if the environment indicates a high risk of fraudulent financial reporting. Research by Hackenbrack [1993] suggests that risk assessment may influence the degree of professional skepticism. This research has not been extended to an analysis of assertion framing at the planning stage. The audit risk approach was criticized, in relation to the WorldCom audit failure by the Report of the Special Investigation Committee ([2003], 226-227). What should be criticized, however, is not the audit risk approach itself but its application: (1) the auditor made an inadequate assessment of the client's control risk and the client's business risk, and (2) the auditor failed to inform the board of directors of the management's restrictions on the auditing procedures.

In summary, the Mode II framework allows the auditor to stay with substantiating positive assertions and not commonly scrutinizing negative assertions. In this sense, this audit risk approach has limited success because it cannot be fully applied as intended. Auditors might feel uncomfortable to explicitly recognizing negative assertions, in particular at the audit planning stage. Or they might refuse to do so.

Mode III: The Positive approach with the Presumptive Doubt view

The strength of the evidence furnished by the positive approach differs depending on whether the auditor takes the neutrality view or the presumptive doubt view of management's honesty. Currently, SAS stipulates the neutrality view. The effectiveness of an audit risk approach is subject to constraints imposed by the framework of professional skepticism (Mode I) because the audit risk approach per se favors "the presumptive doubt view."

The repeated disclosure of fraudulent financial reporting and other management

misconduct in public companies has raised the question of whether the *real* issue is whether management is honest or dishonest. The realization that management may have incentives to distort financial statements should encourage the audit profession to shift its framework of professional skepticism from "the neutrality view" to "the presumptive doubt view." The Panel's (88) recommendation that auditors modify the neutrality view of professional skepticism falls in line with Mode III, under which the auditor would be allowed to substantiate the amounts and/or disclosures in the financial statements based on the presumptive doubt view. Mode III is hypothetical, however, in that the presumptive doubt view is not currently taken by the Statements on Auditing Standards[5].

Bell et al. [2005] and Nelson [2009] are viewed by this author as academic efforts belonging to this Mode (rather than Mode IV), because they do not proactively presuppose negative assertions for the auditor's scrutiny. The expressions "expectations" and/or "compare expectations & observations" used in Figure 3.2 (Bell et al. [2005], 23) state that they stay with "confirmation," not with "falsification." Their proposed audit evidence methodology, called "triangulation," purports to confirm the evidence from the perspectives of three different evidence sources.

In addition, Nelson [2009] defines professional skepticism in auditing as "indicated by auditor judgments and decisions that reflect a heightened assessment of the risk that an assertion is incorrect, conditional on the information available to the auditor" (33). This definition approaches professional skepticism in terms of the degree to which the auditor is sensitive to any material misstatement, but Nelson appears not to assume a negative assertion. Such an approach to the definition is in line with the idea that "the assessment of risk leads the auditor to choose some degree of professional skepticism"(Bloomfield [1997], 519). Both Bell et al. and Nelson pursue the substantiation approach: the level of evidence which is required for a "reasonable basis" or "reasonable belief" is increased and demands a more extensive exercise of professional skepticism. However, although more attention will be paid to the possibility of material misstatements in comparison with Modes I and II, as long as the auditor stays with Mode III, he/she is not allowed to positively or proactively establish negative assertions for scrutiny.

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[5] The Auditing Practices Board has recognized in its recent discussion paper ([2010], 6) that" the recently updated Auditing Standards can be characterized as reflecting a presumptive doubt approach" and has also stated that "an attitude of presumptive doubt is reinforced in ISA (UK and Ireland) 240…. ." But, there has been adverse reaction from the accounting profession (The Auditing Practices Board [2011], 6-7).

Mode IV: The Negative approach with the Presumptive Doubt view

Mode IV is also hypothetical. No approaches to audit evidence so far have assumed negative assertions in verifying the principal proposition. However, unlike the first three approaches, Mode IV demands that the auditor proactively and explicitly recognize negative propositions starting at the planning stage. In other words, the auditor designs program that targets uncovering material misstatements, based on extensive and informed assessment of the client's business risk, internal and external. In particular, the auditor pays attention to any negative signal which may lead to material misstatements, both in gathering and in assessing the evidence. The auditor finally determines whether the evidence falls into an acceptable range of audit risk (the risk that the auditor will incorrectly accept management's assertions as true) by ascertaining that negative propositions are evidentially negated.

The GAAS audit does not anticipate deceit. If deceit is suspected, the auditor will not accept the engagement. But once the engagement is done, the auditor mustascertain whether any material misstatements could be caused by deceit. The auditing profession has recognizes that corporate scandals and/or management fraud have often escaped detection until an enterprise has suffered irreparable damage or bankruptcy. The history of independent audits tells us that experience with many types of fraud schemes may not adequately prepare an auditor to recognize other schemes. There is no "cookbook" approach to detecting fraud that results in material misstatements (Levy [1985], 87). This is the lesson which the accounting profession must learn from its history.

The only way to prepare auditors to recognize fraud is to sharpen their inquisitiveness, to increase their sensitivity to fraud, and to put it another way, to strengthen the depth of professional skepticism starting at the audit planning stage (at the level of recognizing an assertion).The frameworks of professional skepticism represented by Modes I, II, and III naturally lessen their own effectiveness to varying degrees depending on the extent to which the auditor is allowed to explicitly consider negative assertions. A financial statement audit needs to be more robustly contested by bringing the conventional posture of professional skepticism into a new domain.

VII. Concluding Remarks

Audit research has begun to step more into analyses of the effects of confirming evidence and disconfirming evidence in the process of forming the auditor's beliefs, the evidence proneness in the audit planning stage, and their relationship with professional skepticism. From the standpoint of professional skepticism, however, empirical research

so far has dealt almost exclusively with how the disconfirming evidence uncovered during the audit process affects the auditors' degree of professional skepticism and audit judgments. This suggests that within the framework of professional skepticism (Mode I and II) the research has taken up confirming evidence and in particularly disconfirming evidence. In the first place, the auditors being studied may not have had the mindset to recognize explicitly negative assertions (negative propositions), or if they did, it may have been very weak. In general, auditors may be unskilled at dealing with negative assertions and their implications.

Changing the framework of professional skepticism from Modes I and II to III and even to IV, basically means that auditors approach the entire evidence process in terms of negative assertions. Mode IV is the framework to most strongly and fully consider negative assertions. In this sense, a shift in the framework of professional skepticism and the auditor's mindset would require a large change both in audit evidence theory and in audit practice. The author notices that "growing public sentiment demands that auditors should be fraud detectives"(Venuti et al. [2002], 33). Model IV is not intended at all, however, to provide a framework for auditors acting as fraud detectives.

This paper, recognizing that professional skepticism eventually reflects individual personal traits and is in essence a psychological trait, takes a position that, in addition to the personal nature, it is epistemic/philosophical, organizational, economic, structural, and environmental in the sense that it will be subject to influences from the client relationship. Professional skepticism must be understood as a multi-faceted concept.

Audit research, no matter its form, that attempts to measure the depth and breadth of professional skepticism must struggle not only with its hybrid structure, but also with the difficulty of its multifaceted structure. Professional skepticism is a more difficult and broader concept than one would imagine. In this sense, research into professional skepticism in auditing has only just begun.

To conclude this paper, the author would like to borrow the following passage from "The Social Scientist's Obligation" with which Gilovich ([1991], 194) finishes his book:

> What is most important, then, is not dispelling particular erroneous beliefs (although there is surely some merit in that), but creating an understanding of how we form erroneous beliefs. To truly appreciate the complexities of the world and the intricacies of human experience, it is essential to understand how we can be misled by the apparent evidence of everyday experience. This, in turn, requires that we think clearly about our experience, question our assumptions, and challenge what we think we know.

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